PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT.

This is an important document, which you should read and keep.
# INTRODUCTION

1.1 The purpose of this document

1.2 Difference between Principles and Practices

1.3 Changes to the Principles and Practices of Financial Management

1.4 Closure of the With Profits Fund to New Business

1.5 Sale of the Society’s Mature Savings business to ReAssure Limited

# STRUCTURE OF THE SOCIETY

2.1 Ownership of the Society

2.2 Basic structure

2.3 Application of profits

2.4 Types of policy

2.5 Structure diagram

# THE INHERITED ESTATE

# OVERIDING PRINCIPLES

4.1 Background

4.2 Supremacy of the Overriding Principles

4.3 The Overriding Principles

# PRINCIPLES

5.1 The amount payable under a With Profits Policy

5.2 Investment policy

5.3 Business risks

5.4 Charges and expenses

5.5 Management of the Inherited Estate

5.6 Equity between the With Profits Fund, shareholders and Policyholders
### 6 CURRENT PRACTICE

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.1</td>
<td>The amount payable under a With Profits Policy</td>
<td>10</td>
</tr>
<tr>
<td>6.2</td>
<td>Investment policy</td>
<td>10</td>
</tr>
<tr>
<td>6.3</td>
<td>Business risks</td>
<td>16</td>
</tr>
<tr>
<td>6.4</td>
<td>Charges and expenses</td>
<td>18</td>
</tr>
<tr>
<td>6.5</td>
<td>Management of the Inherited Estate</td>
<td>19</td>
</tr>
<tr>
<td>6.6</td>
<td>Volumes of new business</td>
<td>20</td>
</tr>
<tr>
<td>6.7</td>
<td>Equity between the With Profits Fund, shareholders and Policyholders</td>
<td>20</td>
</tr>
<tr>
<td>6.8</td>
<td>Contractual Minimum Addition (CMA)</td>
<td>20</td>
</tr>
<tr>
<td>6.9</td>
<td>Contractual Annual Interest (CAI)</td>
<td>21</td>
</tr>
</tbody>
</table>

### 7 GLOSSARY

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>22</td>
</tr>
</tbody>
</table>
1 INTRODUCTION.

1.1 THE PURPOSE OF THIS DOCUMENT

In 2004 our Regulator implemented rules for the governance of With Profits business. These included the requirement to publish Principles and Practices of Financial Management (PPFM).

This Principles and Practices of Financial Management document is for With Profits business eligible for bonuses. This document is intended to assist With Profits Policyholders in understanding the way in which the Society manages its With Profits business.

It is important to understand that the Principles and Practices of Financial Management set out in this document describe the way in which the Society currently seeks to manage its With Profits business. Management of the With Profits business is not a mechanistic process carried out strictly on the basis of compliance with a detailed set of pre-determined rules, guidelines or criteria. Rather, it requires the Society to make many judgements about the actions it should take in endeavouring to meet the objectives which are described in the Principles and Practices set out in this document.

Those judgements are made by the Society in good faith, with a view to balancing the different interests of individual Policyholders, groups of Policyholders, and Policyholders as a whole. They are based, among other things, upon assumptions about the future, the fulfilment of which clearly cannot be guaranteed by the Society. Equally, the Society cannot guarantee that the judgements it makes will result in the objectives described in the Principles and Practices set out in this document being achieved.

With Profits contracts of insurance are long term in nature. Whilst the Society wishes its Policyholders to have as clear an understanding as practicable of how the Society will seek to manage the With Profits business, it is not in Policyholders’ interests for the Society to do so by reference to rigid and inflexible criteria. The Society therefore seeks to respond to events in managing the With Profits business, and to adapt accordingly the Principles and Practices by reference to which it seeks to carry on that business. These Principles and Practices have evolved significantly over time, in response to changing experience within the With Profits Fund, and changing events outside it, such as changes in investment markets and insurance company legislation and regulation. This evolutionary process is likely to continue into the future.

For these reasons, Policyholders and prospective Policyholders should not treat the statements made in this document as binding commitments on, or binding representations by, the Society as to how it manages the With Profits business or as to how it will do so in the future. Instead, they represent the criteria to which the Society currently has regard, and the objectives it is currently seeking to pursue, in making judgements about the management of its With Profits business. Whilst those judgements are made in good faith, and for the purposes described above, the statements in this document are not intended to enable those judgements to be challenged with the benefit of hindsight.

This Principles and Practices of Financial Management document is published in accordance with the requirements of the Regulator and is not intended to alter the rights and obligations the Society or Policyholders have under any policy documents that the Society has issued. Should there be any conflict between the Principles and Practices of Financial Management and what is said in any such policy document, the latter shall prevail.

The Society maintains governance arrangements designed to ensure that it complies with, maintains and records this Principles and Practices of Financial Management document, as required by the Regulator. The Society keeps these arrangements under review to ensure that they remain appropriate to the scale and complexity of its With Profits Fund and include the approval of this Principles and Practices of Financial Management document by the Board of Directors. The Society’s compliance with this Principles and Practices of Financial Management document and how it addresses conflicting rights and interests of Policyholders and shareholders are subject to review including a review by a With Profits Committee. Currently, the Board of Directors commissions a report from the With Profits Committee to give their independent judgement on this. The Society may from time to time alter these arrangements for obtaining such independent judgement as it may deem appropriate in compliance with the requirements of the Regulator.

Following the review, the Board reports annually on the Society’s compliance with the Principles and Practices of Financial Management document. In addition the With Profits Actuary reports whether the exercise of discretion over the year has taken into account the interests of the different groups of Policyholders in a reasonable and proportionate manner. These reports can be found on our website at: legalandgeneral.com/with-profits/guides

We hope that this document will be helpful in explaining the Practices we adopt, as well as the Principles we apply, in the management and operation of our With Profits business. It does not, however, override any policy document we have issued, the terms of which will continue exclusively to govern contractual relationships.

In addition to the PPFM we publish a ‘Bonus Factsheet, incorporating the PPFM Data Annex’, which contains certain data regarding the With Profits Fund. We aim to publish this at least annually. The latest version can be found on our website at: legalandgeneral.com/with-profits/guides
1.2 DIFFERENCE BETWEEN PRINCIPLES AND PRACTICES

This document has two core elements:

(A) The Principles describe the Society’s aims and objectives in the management of the With Profits Fund and are designed to be long-term in nature. (Both the “Principles” and “Overriding Principles” set out in this document count as Principles for this purpose).

(B) The Practices provide additional detail of the current operation of the With Profits Fund in line with the Principles. Changes to Practices are expected to occur more frequently.

1.3 CHANGES TO THE PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

Principles and Practices may in the future be amended to reflect, among other things, changes to the business, investment markets, or the economic or regulatory environment in which the Society operates.

Any amendments to this document will be carried out in accordance with the regulatory requirements in force at the time. At the time of writing, regulations require that three months’ notice be given of any material change to Principles. No advance notice is required of a change to Practices.

1.4 CLOSURE OF THE WITH PROFITS FUND TO NEW BUSINESS


1.5 SALE OF THE SOCIETY’S MATURE SAVINGS BUSINESS TO REASSURE LIMITED

On 6 December 2017 the Society agreed to sell its Mature Savings business to ReAssure Limited, an entity within the Swiss Re group. With effect from 1 January 2018, the economic risks and rewards of this business, other than expense risk as described in 6.3(B), were transferred to ReAssure via a risk transfer agreement. The policies in the With Profits Fund form part of the Mature Savings business.

The Society Board retains responsibility for all decisions relating to the management of the With Profits Fund, subject to a requirement to obtain consent from ReAssure Limited in relation to certain material matters such as amending these Principles and Practices of Financial Management.

2 Structure of the Society

2.1 OWNERSHIP OF THE SOCIETY

The Society is a wholly owned subsidiary of Legal & General Group Plc.

2.2 BASIC STRUCTURE

With Profits Policies form part of the With Profits Fund, which is part of the Society.

The principal activities of the Society are life and pensions insurance business (with a small amount of General Insurance business).

Within the Society separate accounts are maintained for the With Profits Fund. The capital requirements of the With Profits Fund are assessed on a standalone basis. The capital requirements of the Society are assessed by reference to the capital requirements of the With Profits Fund and the capital requirements of the rest of the Society.

2.3 APPLICATION OF PROFITS

Each year, following an actuarial valuation, the Board decides the amount of profits, if any, which may be set aside as available for With Profits Policyholders’ bonuses or for transfer to the shareholders’ profit and loss account.

For profits set aside for distribution in this way and which are certified by the Board as derived from the With Profits Fund, at least 90% are available for bonuses to With Profits Policyholders. The remainder is available for shareholders.

Profits arising from outside the With Profits Fund are available for the shareholders. With Profits Policyholders are not eligible to participate in these profits.

2.4 TYPES OF POLICY

Both policies eligible for bonuses (With Profits Policies) and policies ineligible for bonuses (Non Participating Policies) are present within the With Profits Fund.

The current range of With Profits Policies has been written since 1954. The range is extensive, comprising:

(A) life insurance policies, including bonds, mortgage endowments and other endowments;

(B) individual and group pensions policies; and

(C) immediate annuities and deferred annuities.

Some policies which are ineligible for bonuses are accounted for in the With Profits Fund (these being Non Participating Policies); others are accounted for in the rest of the Society. The Non Participating Policies in the With Profits Fund generally have been eligible for bonuses previously, or include an option to become eligible for bonuses in the future. Typical Non Participating Policies are unitised policies with an option to switch into Unitised With Profits units, or annuity policies derived from With Profits Policies. As described in section 6.1(A), the Society’s practice is that any surpluses arising in respect of the Non Participating Policies form part of the Inherited Estate.
2.5 STRUCTURE DIAGRAM

The diagram below shows how the With Profits Fund fits into the broader structure of the Society and the Legal & General Group.

3 THE INHERITED ESTATE.

With Profits funds typically have an excess of assets over liabilities and this excess is commonly referred to as the Inherited Estate.

The size of the Inherited Estate can be found from the 'Bonus Factsheet incorporating the PPFM Data Annex' and is updated annually. This can be found on our website at: legalandgeneral.com/with-profits/guides

4 OVERRIDING PRINCIPLES.

4.1 BACKGROUND

Management of the With Profits business of the Society is the responsibility of the Society’s Board of Directors.

The Board will seek to manage the With Profits business with regard to the Principles.

The Principles are intended to be enduring in nature but may be changed if, in the judgement of the Board, it is in the interests of With Profits Policyholders as a whole to do so, to respond to changes in the business or economic environment, or if it is appropriate to do so for the sound and prudent management of the Society’s long-term business as a whole.

4.2 SUPREMACY OF THE OVERRIDING PRINCIPLES

The Principles set out in section 4.3 are Overriding Principles, that is all the other Principles and Practices are subject to them.

Therefore if there is any conflict between an Overriding Principle and another Principle or a Practice, the Overriding Principle will prevail.

The most important Overriding Principle is that the With Profits Fund will be managed with the objective of ensuring that its assets are sufficient to meet its liabilities and other regulatory and capital requirements. We aim to do this without the need for additional capital from outside the With Profits Fund. This Overriding Principle has supremacy over the other Overriding Principles.

4.3 THE OVERRIDING PRINCIPLES

(A) The With Profits Fund will be managed with the objective of ensuring that its assets are sufficient to meet its liabilities and other regulatory and capital requirements without the need for additional capital from outside the With Profits Fund.

To facilitate this, With Profits Policies will share the risks of the With Profits Fund, including business risk such as operational risk, and any profits or losses from the operation of smoothing, guarantees and options on other business written in the With Profits Fund.
5.1 Principles listed in section 4.3. These Principles operate subject to the Overriding Principles listed in section 4.3.

5.1 THE AMOUNT PAYABLE UNDER A WITH PROFITS POLICY

(A) Aims of the methods used
In determining the amounts payable under With Profits Policies, the Board (after receiving advice from the With Profits Actuary) applies methods which it judges appropriate at the time to achieve the following aims:

- To treat all With Profits Policyholders equitably.
- To take account of the returns earned on underlying investments (including any distribution from or deduction to increase the Inherited Estate).
- To take account of the requirement to honour guarantees and options already granted to Policyholders and the degree to which the assets do not provide a full match for the guarantees and options.
- To smooth returns to Policyholders so that some of the short-term fluctuations in the value of the investments of the With Profits Fund and the business results achieved in the With Profits Fund are not immediately reflected in payments.
- To incorporate some pooling and sharing of experience between Policyholders.

In order to treat different types and generations of With Profits investments equitably when applying such methods the Board, where it judges it to be appropriate (after receiving advice from the With Profits Actuary), aims to have regard to differences in product design, such as differences in:

- The nature and extent of guarantees and options provided, in particular in relation to the investments attributed in the calculation of Asset Shares.
- The types and value of risk benefits provided between different types of product and different policies of the same type.
- Taxation between products.

When judging what the Society views as an appropriate degree of approximation to use in the application of the methods, the Society aims to strike a balance between the costs and the benefits of the removal of the approximations.

The With Profits Actuary will report to the Board any material changes in the methodology used.

Where the Society judges it to be appropriate, historical assumptions made in the management and operations of the With Profits Fund, methodology or parameters may be reviewed, for example, as a result of developments in regulation, financial economics, actuarial science and computing technology. Further, as the tax position of the Society is not finalised with HM Revenue & Customs for several years following the end of the financial year to which the tax relates the historical tax assumptions may be subject to review.

Where the Society judges it appropriate to do so in the interests of equity between With Profits Policyholders, it may subdivide experience more finely or change the allocation of investment returns to particular groups of policies and may change historical assumptions or parameters.

Where the Society judges it appropriate, retrospective changes in legislation or regulation may also lead to a review of historical assumptions, methodology or parameters.

(B) Bonus policy
Bonus decisions are made by the Board, after receiving advice from the With Profits Actuary.

For Annual Bonus only business
The Society decides what the Annual Bonus rates should be for each different type of policy and for each generation of Policyholder contributions with a view to achieving the aims described above, while seeking to avoid unduly rapid changes in bonus rates.

See also section 5.1(C) on smoothing policy.
For Annual Bonus plus Final Bonus business
The Society decides what Annual Bonus rates should be for different types of policy and for each generation of Policyholder contributions with a view to building up the guaranteed benefits in a controlled fashion and with the aim of ensuring that the proportion of total benefits projected to be paid in non guaranteed form is at a level the Society judges to be appropriate given:

(i) the overall strength of the With Profits Fund;
(ii) the nature (e.g. volatility) of the assets held within the With Profits Fund; and
(iii) the long-term investment strategy the Society wishes to follow.

Contractual Minimum Addition and Contractual Annual Interest contribute to the build up of the guaranteed benefits. These additions act to reduce the appropriate level of Annual Bonus for investments which receive them.

Final Bonus rates are set by reference to the appropriate total benefits payable so that the sum of the Final Bonus and other benefits equals the appropriate total benefit. The approach to setting Final Bonus rates is therefore effectively a by-product of the approaches to setting total benefits and Annual Bonus rates.

See also section 5.1(C) on smoothing policy.

For all business
The extent of grouping of With Profits Policies for the purpose of setting bonus rates aims to balance the benefit of further subdivision with the principle that in a With Profits insurance contract some pooling and sharing of risks and experience are expected, while aiming to treat all With Profits Policyholders equitably. Greater subdivision by date of investment is considered by the Society to be more appropriate for products which permit single premiums or flexible premiums than for regular premium products.

(C) Smoothing policy and total benefits
With Profits Policies generally provide a combination of smoothing and guaranteed minimum benefits under certain conditions, for example at maturity or normal retirement or death (i.e. Contractual Points).

Other than at Contractual Points, With Profits Benefits are generally not guaranteed. It is intended that benefit levels should not normally lead to an overall strain on the With Profits Fund which could inequitably reduce the amounts ultimately available for payments at Contractual Points. Less smoothing is generally applied to payments not at Contractual Points than to payments at Contractual Points.

When judging what total benefit payments should be, whether or not at Contractual Points, the Society aims to strike an equitable balance between:

(i) those who are claiming;
(ii) those who remain invested in With Profits; and
(iii) the need to remain financially sound.

Therefore benefit payments have regard to the overall financial position of the With Profits Fund, in order that the interests of those who remain invested in With Profits and future Policyholders are not unduly jeopardised. The overall financial position of the With Profits Fund does not depend solely on investment experience, but may also be affected by other experience, such as the cost of guarantees and options, and expense and mortality experience.

The approach to smoothing may depend, among other things, on the expected and experienced amount of claims, as a larger amount of claims has a greater impact on the With Profits Fund. The approach to smoothing for regular premium business may differ from the approach for single premium and flexible premium business, due to the lower variability in premium patterns for regular premium business.

In the long term, the cost of smoothing is intended to be neutral over time.

For groups of policies for which detailed analysis of Asset Shares is carried out, the financial effect on the With Profits Fund of smoothing is monitored by comparing aggregate benefit payments with Asset Shares. However, no formal smoothing account is currently maintained.

The degree of smoothing is generally considered separately for each product type and generation of Policyholders but may be subject to the financial position of the With Profits Fund as a whole.

The Board expects to operate smoothing so that aggregate benefit payments are not systematically above or below Asset Shares.

5.2 INVESTMENT POLICY
The Society aims to ensure that the investment policy has regard to the With Profits Fund’s liability profile. The Board retains flexibility to amend the With Profits Fund’s investment policy to meet changing circumstances. Inevitably, investment policy is likely to change over time in response to both internal and external factors.

Investment judgements are based on a balanced strategy. Money is invested with the aim of balancing risk and reward for groups of policies and for the With Profits Fund as a whole.

The investment guidelines are set by the Board and have regard to the different product groups, with the aim of reflecting the different liability profiles of each product group such as differences in the nature and extent of guarantees and options, as well as to the requirements of the With Profits Fund as a whole.

In judging an appropriate investment policy for assets backing With Profits Policies, including the choice of assets judged to be appropriate for matching of liabilities of a contractual nature, the Board currently considers the level of excess assets:

- within the With Profits Fund; and
- within the rest of the Society’s funds.
This assessment seeks to achieve a balance which the Board judges to be appropriate between risk and return, taking account of the interests of all participants, including shareholders.

No formal constraints are present as a consequence of any past fund mergers or restructures.

Specific matters:

(A) Derivatives

Derivatives (and other instruments which may alter the economic out-turn from assets) may be used by the With Profits Fund where the Society believes that this is likely to reduce investment risk, or improve investment returns, or enable better matching of assets and liabilities, or enhance efficient portfolio management.

(B) Counter-party exposure

The Society aims to manage counter-party exposure so as to balance the risks of the failure of a counter-party against the rewards of dealing with that counter-party.

(C) Assets which are not normally traded

Investments may sometimes be acquired or held in the With Profits Fund which would not normally be traded, such as a subsidiary company or property used by the Society. The Board may judge it to be in the Society's interests to acquire, or hold, such investments in order to provide operational stability which may not be reflected in the open market value of such assets. Judgements as to whether or not it is in the interests of the With Profits Fund to invest in, or maintain an investment in, such assets have regard to the risks, costs and benefits of so doing, and therefore have regard to the open market value, credit quality and liquidity of the assets. Any significant new investment in such assets is subject to Board approval.

The calculation of investment returns to be used in the assessment of With Profits Benefits aims to take account of the returns achieved on the investments backing With Profits Policies, including any material contribution from assets which are not normally traded.

5.3 BUSINESS RISKS

Subject to overriding legislation, With Profits Policyholders and shareholders participate in the experience of the With Profits Fund according to the Articles of Association, and so the With Profits Benefits and shareholder transfers depend on the experience of the With Profits Fund. Such experience includes the outcome of business risks. Examples of business risks are presented in section 6.3.

As explained in section 2.2, separate accounts are maintained for the With Profits Fund. Therefore, in the first instance, profits or losses arising from non profit business written outside the With Profits Fund pass to the shareholders.

When judging whether compensation costs and other profits or losses of the Society should be allocated within the With Profits Fund, to With Profits Policies or to the Inherited Estate, or outside the With Profits Fund, the nature and extent of the costs are taken into account, as well as any relevant legislation or applicable rules.

When considering the nature and extent of business risks taken, the Society seeks to achieve what it regards as an appropriate balance between risk and reward. The Society seeks to manage concentrations of risks within the Society and the With Profits Fund in a sound and prudent manner.

5.4 CHARGES AND EXPENSES

With Profits Policies participate in expense experience incurred by the Society in operating the With Profits Fund (including a fair proportion of overheads) including the risk of expense overruns.

The Society’s judgements on the apportionment of expenses aim to be equitable, having regard to the contribution of each particular class of policies to the expenses and at the same time seeking to avoid undue bias in favour of one group of Policyholders over another.

Generally, for Accumulating With Profits Policies, explicit deductions act to determine the relative levels of benefits within a group and are taken into account in setting bonus rates, with the objective of endeavouring to strike an equitable balance between different policies. For Conventional With Profits Policies there are generally fewer explicit deductions inherent in policy terms.

A change in the basis of apportionment of expenses may, for example, be driven by developments in techniques of expense analysis which make it practical to change the extent of approximations made in the management and operation of the With Profits Fund.

5.5 MANAGEMENT OF THE INHERITED ESTATE

The Society’s objective is to manage the With Profits Fund so that its assets are sufficient to meet its liabilities and other regulatory and capital requirements without the need for additional capital. The Board has regard to both the current financial position of the With Profits Fund and projections of its future financial position when considering the management of the Inherited Estate.

With Profits Policies have had no expectation of any distribution from the Inherited Estate while the With Profits Fund remained open to new business.
Following closure of the With Profits Fund to new business on 31 January 2015, the Board will consider annually whether part of the Inherited Estate should be distributed to With Profits Policyholders. In adverse circumstances this may result in a deduction from investment returns in order to increase the value of the Inherited Estate. The amount and timing of any distribution from or deduction to increase the Inherited Estate shall be determined by the Board. It is possible that in the future, a proposal for restructuring the With Profits Fund might be recommended by the Board, which might then be put to With Profits Policyholders and shareholders for their approval.

In making judgements regarding the management of the With Profits Fund, the Society seeks to maintain an Inherited Estate of a size which the Board considers appropriate in order to:

- Provide flexibility in investment management, thus potentially increasing policy benefits.
- Enable policy benefits to be smoothed.
- Avoid certain outgoings from the With Profits Fund being charged directly to policies. See section 6.1(B) for further details.
- Take account of future potential adverse experience.

### 5.6 EQUITY BETWEEN THE WITH PROFITS FUND, SHAREHOLDERS AND POLICYHOLDERS

Separate accounts are maintained for the With Profits Fund.

The Articles of Association currently provide that not less than 90% of any profits distributed from the With Profits Fund are available for distribution to With Profits Policyholders. The remainder of any distribution from the With Profits Fund is available for distribution to shareholders.

Proposed changes to the profit sharing arrangements (other than via the discretion that the Articles of Association currently grant) would require changes to the Articles of Association. The Society would follow relevant regulatory requirements in proposing such changes, informing and involving With Profits Policyholders as appropriate.

### 6 CURRENT PRACTICE.

These Practices operate subject to the Principles listed in sections 4 and 5.

### 6.1 THE AMOUNT PAYABLE UNDER A WITH PROFITS POLICY

#### (A) Methods

Currently the Society uses a variety of methods to judge appropriate levels of With Profits Benefits, with a view to achieving the aims described in section 5.1.

Among other things, the methods aim to have regard to differences in past experience of groups of policies, such as:

- investment returns;
- the level of expenses and commission incurred by the With Profits Fund at different times and in the management of different products;
- the level of transfers to the shareholders;
- past payments on death, surrender or transfer, regular withdrawals or one-off withdrawals;
- the nature and extent of the guarantees and options provided, in particular taking into account the investments attributed in the calculation of Asset Shares;
- as well as having regard to such experience in aggregate in order to manage the overall capital position of the With Profits Fund and to enable guarantees and options to be honoured.

On a regular basis, historical Asset Shares for groups of policies are calculated, having regard to differences in past experience between groups as described above, and also allowing for any share in profits or losses arising from other business in the With Profits Fund which the Board may decide to attribute to these policies.

There are Non Participating Policies present in the With Profits Fund as described in section 2.4 above. The Society’s current practice is that any surpluses or strains arising in respect of the Non Participating Policies form part of the Inherited Estate and therefore do not accrue directly to Asset Shares, although this is a discretionary practice of the Board which is kept under review and may be subject to change if the Board deems it appropriate.

Asset Shares are calculated by assessing the premiums received net of payments to Policyholders, expenses and other deductions (for example for the cost of guarantees and options, and the transfers to the shareholders) plus any attributed share in profits or losses arising from other business in the With Profits Fund. These sums are then accumulated with Adjusted Investment Returns, allowing for tax (including an allowance for tax in relation to unrealised capital gains or losses).

In order to determine bonus rates, the Board takes into account the current level of benefit payments compared to Asset Shares.

Asset Share calculations are performed for the With Profits Fund as a whole, so that the overall affordability of bonus proposals can be examined.

For Unitised With Profits business bonus investigations, the Asset Shares calculations are based on Specimen Policies constructed to represent the portfolio of business for which bonus affordability is being assessed (excluding some significantly altered policies). The results are expressed as separate bonus affordability figures for each bonus pool within each bonus series.

For Conventional With Profits (Life) business (excluding Cashbuilder) bonus investigations, the Asset Share calculations are based on Specimen Policies currently in force.
Policies constructed to represent the portfolio of business for which bonus affordability is being assessed, grouped by entry date and maturity date. This excludes Whole of Life policies and some significantly altered policies for which Asset Share calculations are not performed when investigating bonus affordability and so these policies are allocated bonus rates applicable to the main lines of Conventional Life. The results are expressed as separate bonus affordability figures for each bonus entry year. For most Cashbuilder business a similar approach is followed, with grouping by entry year.

For Personal Retirement Plan business bonus investigations, the Asset Share calculations are based on Specimen Policies constructed to represent the portfolio of business for which bonus affordability is being assessed. The results are expressed as separate bonus affordability figures for each bonus pool.

For Conventional Buy Out Plan business bonus investigations, the Asset Share calculations are based on the actual policies in force. The results are expressed as separate bonus affordability figures for each bonus pool.

For With Profits Annuity business bonus investigations, the Asset Share calculations are based on the portfolio of business for which bonus affordability is being assessed. The results are expressed as separate bonus affordability figures for each bonus pool.

For Private Income Plan and Adaptable Pension Plan business bonus investigations, the Asset Share calculations are based on Specimen Policies for business written on different terms, grouped by entry date. The results are expressed as separate bonus affordability figures for each bonus pool within each bonus series.

For other pension business, bonus investigations do not rely on Asset Share calculations.

Other factors taken into account in formulating bonus proposals (whether in conjunction with Asset Share calculations or otherwise) include:

- Comparison of Policyholder returns with underlying investment returns on the assets within the With Profits Fund.
- Comparison of benefits on different generations of the same product.
- Comparison of benefits on similar generations of different products.
- Comparison of benefits on similar products offered by competitors.

Projections of Asset Shares and benefit payments are also performed, both for groups of policies and for the With Profits Fund as a whole, in order that the expected future progress of bonus rates, the level of guaranteed benefits as a proportion of total benefits, and the future overall affordability can be better understood by the Board. These projections are based on assumptions for the future determined by the Society.

The treatment of partial payments from a policy without Market Value Reduction or surrender charge depends, among other things, on the contractual terms and the purpose of the policy in question.

Past regular withdrawals from investment bonds are taken into account when calculating Asset Shares used in the analysis of bonus affordability.

Actual annuity payments from With Profits Annuities are taken into account when calculating Asset Shares used in the analysis of bonus affordability.

Smoothing on payments from a bonus pool at certain Contractual Points is not charged directly to the Asset Shares for those policies remaining in the pool. Examples of such payments include:

- Maturity payments under a Unitised With Profits endowment.
- Normal retirement payments under a Unitised With Profits pension while units on other policies remain invested in the pool.
- Retirement on or after age 60 from a Personal Retirement Plan.
- Encashment of a Cashbuilder on or after the tenth anniversary.

(B) Assumptions

Regular experience investigations are performed in order that the calculation of Asset Shares can reflect experience and in order to seek to test the appropriateness of the grouping of policies.

The degree of approximation which the Society allows in its decisions (for example, when the Society applies assumptions or parameters across generations of With Profits Policyholders or classes of policy) aims to strike a balance between the costs and benefits of increased accuracy.

The material methods, parameters and assumptions, in particular any significant changes since the previous investigation, used to determine bonuses and amounts payable are formally reported to the With Profits Actuary as part of the bonus investigation process within the Society.

Board decisions are recorded and the detailed approach to their implementation is documented.

Changes to the material methods and parameters for the calculation of Asset Shares are agreed with the With Profits Actuary and documented in an annual parameter paper. Significant changes are included by the With Profits Actuary in bonus reports to the Board and are subject to Board approval.

Investment returns

Earned investment returns are recorded using established accounting methods.

In the assessment of Asset Shares, the methods make allowance for any material contribution from
assets which are not normally traded.

Investment returns applied in the calculation of Asset Shares are calculated using different asset mixes for different groups of policies. The scope and form of such differentiation have developed over time and are expected to continue to develop in the future.

In scenarios when market conditions mean that it is not possible to make a reasonable and reliable assessment of investment returns using the approach normally adopted then an alternative approach may be used with the objective of ensuring fair treatment of different generations of Policyholders. Where assets would normally be realised to meet claims payments but market conditions mean that this is not possible then an adjustment to the investment returns credited to Policyholders making claims may be made to ensure fair treatment of continuing Policyholders.

Following closure of the With Profits Fund to new business on 31 January 2015 the Board may, after considering the advice of the With Profits Actuary, increase or reduce Asset Shares by increasing or reducing investment returns taking into account the requirement to treat all policyholders fairly as well as ensuring that at all times the Inherited Estate is adequate to achieve the objectives in 5.5.

Expenses and commission

Expenses incurred in operating the With Profits Fund (including a fair proportion of overheads) are attributed to With Profits Policies, and between different groups of With Profits Policies, in accordance with allocation bases determined by the Society. Commission is charged to the groups of policies in respect of which it was incurred. The remaining expenses are generally apportioned on the basis of an assessment of the costs incurred in acquiring and administering the policies. The basis of apportionment is regularly reviewed for equity and varies according to category of expense. For most business, sales expenses are apportioned in accordance with new business volumes at the time and administration expenses are apportioned in accordance with numbers of policies administered within broad policy types.

With effect from 1 January 2018, the Society and the With Profits Fund made an expense agreement under which expenses relating to the With Profits Fund are fixed across all product groups except for:

- Expenses relating to new and incremental business;
- Expenses in relation to any compensation or redress to a policyholder or former policyholder arising from actions prior to 31 July 2009;
- Any rectification payments.

This agreement continues until 30 June 2020, but may be extended by the Society beyond that date.

For expenses charged to the With Profits Fund, details of the level of expenses to be charged to the Inherited Estate, rather than to Asset Shares, for the purposes of formulating bonus proposals, are documented in product pricing reports. Any subsequent changes to these expenses by product type or generation applied in the analysis of bonus affordability are documented in the With Profits Actuary’s bonus reports to the Board and are subject to Board approval.

The level of expenses deducted from Asset Shares for some product types and generations has been capped, as follows:

- Initial expenses for most Unitised With Profits (Life) business written since 1995.
- Initial expenses on some Conventional With Profits (Life) business sold in the late 1980s and early 1990s.
- The accumulated deductions for some Personal Pension Plan 2000 contracts (post 5 April 2001 members), excluding any deductions or refunds (for example in respect of guarantees and options under 6.4(B)), are capped at the level of the accumulated explicit charges made.
- Since 1995 the levels of initial and (since 1997) renewal expenses for most other new Unitised With Profits (Pensions).

Further caps may be applied where the Society Board considers this to be appropriate.

Where expenses are not capped, the same expense deductions, excluding certain exceptional expenses charged to the Inherited Estate, are applied to Asset Shares as are borne by the With Profits Fund, suitably apportioned.

Expenses in excess of the cap are charged to the Inherited Estate. Such expenses affect the financial position of the With Profits Fund as a whole and so can still influence the bonus declarations for both the capped products and other With Profits Policies.

Past payments to With Profits Policyholders

Information from policy records is investigated using established actuarial techniques in order to generate historical lapse, surrender and mortality rates which reflect the experience of the groups of policies being investigated, which may then be applied in the calculation of Asset Shares.

Taxation

The tax charged to the With Profits Fund aims to be a realistic reflection of the liability for tax arising in respect of the business and activity within the With Profits Fund on a stand-alone basis, without incorporating the effects of tax synergies or dissynergies between different parts of the Society. The tax charges modelled in the calculation of Asset Shares reflect the tax charged to the With Profits Fund and also include an allowance for tax in relation to unrealised capital gains or losses.
Shareholder transfer

The amount which may be deducted from Asset Shares in respect of the transfer to shareholders is currently subject to a maximum.

In determining this maximum amount, the additional liability to tax in respect of the transfer to shareholders was included for periods up to and including the transfer as at 31 December 2004, but is excluded thereafter under current regulations. (The additional liability to tax was, up to and including 31 December 2004, met by the With Profits Fund, either from Asset Shares or from the Inherited Estate depending on product type. Since that date, the additional liability to tax is met by the Inherited Estate). This maximum deductible from Asset Shares was therefore, for periods up to and including the transfer as at 31 December 2004, 10% of Distributed Surplus plus the additional tax on that 10% of Distributed Surplus, and is, since 31 December 2004 and currently, 10% of Distributed Surplus.

Contractual Annual Interest and Contractual Minimum Addition are not bonuses, and so do not generate a transfer to shareholders.

As is the case for expenses, the deduction from Asset Shares may be lower than the total of the transfer to shareholders and (where included in the maximum deductible) the additional liability to tax in respect of the transfer to shareholders. The deduction from Asset Shares varies by product type and generation. It is expected that for periods after 31 December 2004 similar deductions to those applicable for earlier periods will be made, except that a limit of the transfer to shareholders will be applied.

For Personal Pension Plan 2000 contracts (post 5 April 2001 members) the full transfer to shareholders (plus additional tax for periods up to and including the transfer as at 31 December 2004) is added to the other deductions and this total is accumulated. In the calculation of Asset Shares used in the analysis of bonus affordability it is this total accumulated deduction, excluding any deductions or refunds in respect of guarantees and options under section 6.4(B), that is capped at the level of the accumulated explicit charges made.

The cost of bonus used in the calculation of the deduction from Asset Shares in respect of the transfer to shareholders is currently the increase in the regulatory value of the liabilities arising from the bonus addition, with the exception that it currently excludes the element within the regulatory basis for the cost of guaranteed annuity options on the bonus added.

The transfer from the With Profits Fund to shareholders is generally currently determined as one ninth of the aggregate of distributions to With Profits Policyholders in advance of surplus and the cost of bonus calculated using the published regulatory valuation basis, although a different proportion may apply, for example if provided for by the terms of a policy. The difference if any between this full transfer, together with any associated tax, and the allowance deducted from Asset Share is charged to the Inherited Estate. For new business written after 30 June 2012, other than in relation to any associated tax, it is not expected that any deduction in respect of any difference between the full transfer and the allowance deducted from Asset Share will be charged to the Inherited Estate.

The foregoing represents the current practice adopted by the Society in relation to transfers to shareholders. The Society has discretion under the Articles of Association to vary the basis upon which transfers to shareholders are made and may choose to do so from time to time, subject to complying with the regulatory requirements in force at that time and any commitments made to Policyholders.

When Distributed Surplus arises in the With Profits Fund in respect of any year, the proportion of that Distributed Surplus allocated to shareholders is transferred immediately to the shareholder funds of the Society. The proportion of Distributed Surplus allocated in respect of each With Profits Policy continues to be invested within the With Profits Fund until that policy matures, lapses, is surrendered or there is a payment on death. Upon lapse or surrender, the terms of certain Unitised With Profits Policies may permit the Society to apply a Market Value Reduction. Where such an adjustment is applied, there is a corresponding reduction in Distributed Surplus allocated to shareholders. Hence the proportion in which Distributed Surplus is initially allocated between the With Profits Policyholders and the Society’s shareholders does not change when policies lapse or surrender.

Guarantees and options

The effect of differences in the level of guarantees and options has been taken into account when determining appropriate levels of bonuses in the following ways:

(i) For Buy Out Plans, an explicit deduction is made from the investment returns used in the Asset Shares for bonus affordability calculations.

(ii) For some contracts (for example Cashbuilder) payouts are compared with those on similar Conventional With Profits (Life) policies within the With Profits Fund and are generally targeted at a lower level to reflect the more extensive guarantees and options.

(iii) For some contracts the investment returns used in the Asset Shares for bonus affordability calculations are based on a mix of assets containing a higher fixed interest content than others. Further information on the mix of assets used in bonus calculations for particular groups of policies can be found in the ‘Bonus Factsheet incorporating the PPFM Data Annex’ on our website at: legalandgeneral.com/with-profits/guides
In addition, charges (or refunds of past charges) as described under section 6.4(B) may be applied. These would reduce (increase) the Asset Share used for bonus affordability calculations.

**Assumptions for the future**

Assumptions used to calculate the amount payable under With Profits Policies are set at levels which are judged by the Society to be realistic estimates of possible future experience, taking into account past and current experience plus trends. However, no assurance can be given that such assumptions will be fulfilled.

**Bonus rates**

In formulating the amount of the bonuses payable under With Profits Policies, the Board is currently guided by objective formulae designed to set recommendations for bonus rates which are fair to With Profits Policyholders as a whole. At present the formulae aim to establish a smoothing of Payout Ratios which targets an overall payout of 100% of Asset Share over a period of time. The Society keeps the formulae under review with the aim of ensuring that such formulae remain appropriate to the management of the With Profits Fund. The Board is not bound by the result of the formulae and may use its discretion otherwise to set the amount of bonuses payable and to vary the basis on which bonus rates are calculated.

Annual Bonuses are currently set annually and added to policies in arrears. There is no preset maximum change in Annual Bonus rates but the Society endeavours so far as possible, and subject to other constraints on the With Profits Fund, to avoid unduly rapid changes in Annual Bonus rates for With Profits Policies from year to year, in particular, by means of the smoothing policy described in section 6.1(D).

An Interim Bonus may be payable in respect of any period for which an Annual Bonus rate has not been declared. For Unitised With Profits Policies and most other Accumulating With Profits Policies, Interim Bonus rates are set at the level at which the Society would expect subsequently to declare as the Annual Bonus rates for the period in question, unless there are strong investment or tax reasons to do otherwise. However, Interim Bonus rates are not guaranteed and can be changed without notice to Policyholders.

Additionally, for Eligible With Profits Contracts the rate of Contractual Minimum Addition changes with effect from 1 January each year and the Interim Bonus rate is normally adjusted with effect from 1 January to leave the total of the Interim Bonus rate and the rate of Contractual Minimum Addition unchanged.

For Annual Bonus only bonds the Interim Bonus rate determines the rate at which bonus linked regular withdrawals can be paid without application of a Market Value Reduction. Consequently the Interim Bonus rate is normally changed with effect from 1 January, rather than at the Annual Bonus declaration.

Final Bonus rates were introduced for relevant policies in 1972. (The Temporary Bonus was introduced in 2000 with the introduction of With Profits Annuity policies). These bonus rates have normally been set annually. However, where investment conditions have made it appropriate there have been mid-year changes to rates.

Rates of Interim Bonus and Final Bonus are reviewed frequently and may be changed or withdrawn without notice to Policyholders.

Conditions which might give rise to a change in Interim Bonus, Final Bonus or Temporary Bonus rates (as the case may be) include changes in investment conditions resulting in inappropriate returns to With Profits Policyholders on the premiums paid or an inappropriate balance between those whose policies will imminently become claims and those whose policies are due to become claims further into the future.

The current approach to setting Final Bonus and Temporary Bonus rates is a by-product of the current approaches to setting total benefits and Annual Bonus rates, as described above and in section 6.1(D).

Final Bonus takes final account of the contribution made by the relevant group of With Profits Policies or the relevant bonus pool to the available profits. Temporary Bonus takes account year by year of the contribution made by the relevant group of With Profits Annuity Policies to the available profits.

Final Bonus rates vary by type and generation of With Profits investment, and normally depend upon how long an investment has been participating in profits.

Payments not at Contractual Points (for example switch, surrender, transfer or early retirement payments) may be subject to a Market Value Reduction. To effect such a reduction, a Market Value Reduction Factor is applied to the constituent parts of the payment, including any Final Bonus element.

For Conventional With Profits Policies, an allowance for Final Bonus is made in the calculation of surrender values. This allowance varies by product type and generation. The total surrender value payable, where discretionary, is set with regard, among other things, to Asset Shares for groups of policies. The notional Final Bonus element of the surrender value is calculated in order to determine the amount of the surrender payment to be included in the calculation of Distributed Surplus, so that the transfer to shareholders can be calculated.

Both historical economic experience and prospects for the future are taken into account by the Society in determining appropriate bonus rates, by comparing projected benefits with projected Asset Shares.
**Smoothing and total benefits**

The general aim of smoothing is that some of the fluctuations in the market value of the assets backing policies in the With Profits Fund and other experience are not necessarily immediately reflected in payments under With Profits Policies. However, the approach to smoothing differs between products.

Currently when determining appropriate levels of payments at maturity, normal retirement or on death, returns to Policyholders are compared with those available previously for policies with the same starting date. When determining benefits, the Board aims to smooth such returns over time.

Changes to bonus rates and other withdrawal terms mean that policy benefits may not be continuous from one day to the next.

Subject to the Overriding Principle that the With Profits Fund will be managed with the objective of ensuring that its assets are sufficient to meet its liabilities and other regulatory and capital requirements without the need for additional capital from outside the With Profits Fund, the approach to smoothing for one class or generation of With Profits business is currently considered by examining the experience of that business on its own merits with particular emphasis on investment experience, but also having regard to any deductions or refunds (for example in respect of guarantees and options under 6.4(B)). There are no fixed limits on the total cost of smoothing and no limit on the potential changes in maturity payments between one period and another although the Society does apply a consistent approach towards smoothing of benefits for each type and generation of policy between periods.

For Annual Bonus only bonds, smoothing of benefits currently focuses both on the total claim value payable on death and on the interim running yield, which defines the level of bonus-linked regular withdrawals.

For other contracts, except With Profits Annuities, smoothing of benefits currently focuses on the total claim value payable at maturity, normal retirement date or on death.

For With Profits Annuity contracts smoothing of benefits currently focuses on the annuity payments due in the coming year.

For groups of policies for which bonus investigations rely on Asset Share calculations, the most important guide to determining appropriate levels of payments is the ratio of benefits to Asset Share – the Payout Ratio.

For such business, the Board aims to set payments at maturity or normal retirement date so that Payout Ratios are in the range 80% to 120% for most business (unless the effect of policy guarantees leads to higher Payout Ratios). In the longer term the Board aims to make aggregate benefit payments at maturity or normal retirement date amount to 100% of the respective Asset Share, unless the effect of policy guarantees leads to higher benefit payments. All of the aims are targets, and it is not guaranteed that benefit payments will fall within those aims.

Final Bonus, which can be increased or reduced, allows policy benefits to be changed rapidly if appropriate, thus enabling Payout Ratios to be managed. For Annual Bonus only bonds, Final Bonus is not used in the management of the Payout Ratio.

Past smoothing decisions have had an impact upon the capital resources of the With Profits Fund. Current and future smoothing decisions will have an impact upon the capital resources of the With Profits Fund. When determining appropriate benefit payments, the Board has regard both to the interests of those who are leaving the With Profits Fund and those who remain invested in it. Consequently the amount of capital resources of the With Profits Fund has an impact on smoothing decisions, and so past smoothing decisions have an impact on current smoothing decisions.

The degree of smoothing depends on the investment and other experience within the With Profits Fund. Future experience cannot be predicted with certainty, and so the speed and extent of changes to With Profits Policyholder benefits are not known in advance.

Current practice is that no absolute limits to the scale of smoothing are applied. When considering the scale of smoothing, the Society makes a judgement as to whether smoothing is likely unduly to jeopardise the interests of remaining With Profits Policyholders.

**Benefits not at Contractual Points**

Discretionary payments not at Contractual Points (for example on switch, surrender, transfer or early retirement) are reviewed regularly. The frequency of changes to the level of payments depends on movements in the market values of assets and the degree of smoothing. Typically, less smoothing will apply at Non Contractual Points.

It is intended that early withdrawals should not lead to a material overall strain on the With Profits Fund. However, many policies have been written on a basis whereby the initial expenses of selling and setting up a policy are not recouped through charges made in the early years. In such circumstances, any deficit or excess would be applied as an adjustment to the investment return credited to Asset Shares for the remaining policies in that pool, as the method used to determine appropriate levels of With Profits Benefits has regard to past experience.
Discretionary payments not at Contractual Points generally have regard to Asset Shares. However, the Society aims to set such payments at a level which it judges is unlikely unduly to jeopardise the interests of remaining With Profits Policyholders. Therefore both the amount of withdrawals and the amount of capital resources of the With Profits Fund as a whole may influence the level of discretionary payments. However, in relation to the amount of withdrawals, this will only be the case where any Market Value Reduction to be made is no greater than necessary to reflect the impact of the difference in market value and assumed value of the With Profits assets on the relevant payment to the Policyholder.

For Conventional With Profits policies, the bases for calculating surrender values are reviewed annually following the bonus declaration and may also be reviewed at other times during the year, such as in the event of market movements that differ significantly from the investment return assumptions used in calculating bonuses. In reviewing the bases for calculating surrender values, the Board has regard to the Payout Ratios.

For Unitised With Profits policies, Payout Ratios are calculated on a frequent basis and surrender values may be calculated by means of applying a Market Value Reduction Factor. There are some single premium Unitised With Profits Policies where the particular policy terms permit partial withdrawals which, up to certain limits, are not subject to Market Value Reductions.

For groups of policies for which bonus investigations rely on Asset Share calculations, the Board aims to set discretionary payments other than at Contractual Points so that Payout Ratios are in the range 80% to 120% for most business. The Board sets payouts for discretionary payments other than at Contractual Points with the aim of smoothing to 100% of the respective Asset Share in the longer term. All of the aims are targets, and it is not guaranteed that benefit payments will fall within those aims.

Generally Market Value Reduction Factors are set at the same level of subdivisions as bonus rates, for example based on annual pools or quarterly pools to correspond with bonus rate subdivisions. For regular premium Unitised With Profits (Life) business, due to the lower variability in premium patterns, Market Value Reduction Factors are subdivided to a lesser extent than for single premium and flexible premium business.

Currently only a proportion of the full Market Value Reduction is applied near to the maturity date (or the premium off date for Prospects Savings Plans) for regular premium Unitised With Profits (Life) business. The full Market Value Reduction is applied to other Unitised With Profits business.

Subject to the amount of capital resources of the With Profits Fund as a whole, other than as a result of short-term fluctuations, Market Value Reductions will not be applied if the investment return achieved on the relevant With Profits pool is more than that which is required to support bonuses, after taking account of any deductions or refunds not yet made (for example in respect of guarantees and options under section 6.4(B)).

Currently Conventional With Profits (Life) surrender values move towards maturity values for policies near maturity. For Personal Retirement Plan contracts, transfer values currently move towards normal retirement open market option values over the period from age 55 to age 60.

For some smaller classes of business the benefits to the With Profits Fund of actively managing withdrawal terms are small. Less active management is currently applied for such classes.

For bulk discontinuance of certain group pension schemes where large premium payments have been made, for example Trustee Investment Plans, Market Value Reduction Factors are subdivided to a greater extent than are bonus rates.

6.2 INVESTMENT POLICY

(A) Matching

The Society aims to ensure that the investment policy for the With Profits Fund has regard to its liability profile and therefore seeks to maintain a mix of investments between equity, fixed interest securities, property and other assets which takes into account the level of guarantees attached to liabilities and duration of the liabilities.

Thus the proportion of fixed interest investments takes into account, among other things, the existence of guarantees and options attaching to policies.

Tests are carried out to assess the impact of departure from a matched position between assets and liabilities, having regard to the amount of capital resources of the With Profits Fund and the expected impact on returns to With Profits Policyholders.

(B) Scope of investment policy

The With Profits Management Committee (or any successor Committee) under a delegated authority from the Society Board sets guidelines for the investment of assets backing both Asset Shares (for those groups of With Profits Policies for which Asset Shares are calculated) and liabilities (for groups of With Profits Policies for which Asset Shares are not calculated). Different guidelines are set for the assets backing Non Participating Policies, funds held to back guarantees and options as described in section 6.4(B) and for the balance of the assets which comprise the Inherited Estate.
Investment decisions in respect of the balance of the assets which comprise the Inherited Estate have regard to Overriding Principle 4.3(A) and the aim to maintain sufficient capital resources to allow some freedom in the determination of the asset mix used in the calculation of Asset Shares. These guidelines are subject to review as described in section 6.2(C), which means that, for example, the proportion of assets invested in equities may reduce over time if the With Profits Asset and Liability Committee (or any successor Committee) considers it appropriate to do so.

The asset mix applied to determine investment returns used in the calculation of Asset Shares may differ, and has differed, from the mix of the assets held. Differences may arise as a result of the aim to reduce the susceptibility of the With Profits Fund as a whole to adverse investment conditions. Differences may also arise due to it being efficient to buy and sell certain investments, such as derivatives, in tranches which do not equate precisely with amounts of With Profits business in respect of which the investments are being bought or sold.

Assessment of the appropriate level of policy benefits for particular groups of policies has regard to achieved and expected future investment returns. Investment returns based on different asset mixes are currently applied in these assessments for broad groups of policies.

The Society employs further differentiation of asset mix based mainly on the outstanding period until benefits are payable at a Contractual Point (“Outstanding Duration”) and/or the value of the guarantees and options provided, and may make further changes in the future. For groups for which the Outstanding Duration is shorter and/or the guarantees and options have greater value, the increases in capital requirements and the investment risk within the With Profits Fund resulting from investment in assets such as equities and property are greater than for other groups. The main effects of such differentiation are that the proportion of fixed interest securities and/or the use of derivatives may be greater for groups for which the guarantees and options have greater value than for other groups. Consequently the proportion of assets held in equity and property would be lower; and groups for which the Outstanding Duration is shorter may hold fixed interest securities of shorter duration or with more cash-like characteristics.

In respect of derivatives, to the extent that the Board considers it appropriate, the Society may acquire various types of derivatives and hedging products when managing investments backing With Profits Policies. Such derivative and hedging products are acquired where the Society believes that this is likely to reduce investment risk, improve investment returns, enable better matching of assets and liabilities, or enhance efficient portfolio management. These derivatives and hedging products may include options to buy and sell particular assets in certain circumstances, financial futures and other products which seek to limit losses in the event of a fall in market values.

(C) Review of investment policy
A full review of investment policy is carried out annually by the With Profits Asset and Liability Committee (or any successor Committee), with smaller reviews occurring more frequently to monitor and, where appropriate, take account of the experience of the With Profits Fund. During the review, the With Profits Asset and Liability Committee considers, amongst other things, market conditions, the size of the Inherited Estate, the financial condition of the With Profits Fund, the range of With Profits Policies, the nature of particular With Profits Policies and their remaining term until maturity, and whether it is appropriate to change the asset mix for particular types of With Profits Policies in the particular circumstances.

(D) Investment management (asset allocation and stock selection)
The assets in the With Profits Fund are currently managed by Legal & General Investment Management Limited, a wholly owned subsidiary of the Legal & General Group, and certain external investment managers. These fund managers manage the mix of assets and stock selection in accordance with the strategy set by the With Profits Asset and Liability Committee (or any successor Committee).

In the strategy set by the With Profits Asset and Liability Committee (or successor committee), the asset allocation decisions are expressed as allocation benchmarks.

Freedom is given to diverge from these allocation benchmarks within specified operating ranges. The allocation benchmarks and operating ranges are reviewed on a regular basis. The fund managers are given performance benchmarks, objectives and guidelines as to stock selection and have the freedom to select the stock in which to invest taking account of these objectives and guidelines. Further details are given in this section 6.2 and in section 6.4(C).
6.3 BUSINESS RISKS

Policyholders and shareholders share business risk, such as:

(A) profits or losses arising from the operation of
smoothing, guarantees and options on With Profits Policies;

(B) profits or losses arising from the expenses of
maintaining and acquiring participating With Profits Policies increasing or decreasing subject to the
expense agreement further described in paragraph 6.1(B) which means that the With Profits Fund is not
currently exposed to the majority of the business
risk relating to expenses;

(C) profits or losses from mortality, sickness and
withdrawal experience of With Profits Policies;

(D) profits or losses arising from Non Participating Policies;

(E) changes in taxation or other legislation or
regulation;

(F) risks from other investments, for example, in
investment management companies, service
companies or overseas subsidiary insurance companies. The With Profits Fund currently has no
significant investment in such companies;

(G) risks from failure of a third party, for example,
a reinsurer; and

(H) costs from operational risks, such as compensation
costs.

Currently profits and losses from Non Participating
Policies are attributed to the Inherited Estate as opposed
to Asset Shares. Therefore they do not influence Asset Shares directly, but do indirectly by contributing to the
amount of Inherited Estate and affecting the capital
resources of the With Profits Fund. In extreme conditions,
for example when the capital requirements of the
With Profits Fund are in danger of potentially not being
met, such losses from Non Participating Policies may be
charged directly to With Profits Policies.

Currently profits and losses from business risks on
With Profits Policies, other than any deductions or
refunds (for example in respect of guarantees and
options as described in section 6.4(B)), are generally
distributed among groups of similar policies or accrue
for the benefit or detriment of the Inherited Estate. No
general limits are set below which such profits and
losses are not distributed, that is there is no ‘de minimis’
rule generally applied. Currently, except where otherwise
stated, profits and losses arising from business risks are
generally distributed to Asset Shares, notable exceptions
at present being compensation and costs associated
with regulatory reviews, and certain expenses of an
exceptional nature. The Board, after receiving advice
from the With Profits Actuary, determines whether
profits or losses attributable to the With Profits Fund
from business risks on With Profits Policies are applied to
Asset Shares or to the Inherited Estate.
Distribution of business risk outcomes would normally be via an adjustment to the credited investment return or directly in the Asset Share calculations. Some smoothing of the impact of profits and losses from business risks is generally applied, so that their impact is not immediately reflected in payments from policies.

Business risk is monitored by Committees chaired by Directors of the Society. Pricing and insurance risks from product terms are monitored by the Group’s Insurance Risk Committee. This Committee is a Sub-Committee of the Group’s Executive Risk Committee which also considers wider operational risks.

When considering the nature and extent of risks taken, the balance between risk and reward, and concentrations of risks, are considered with the objective of managing the With Profits Fund in a sound and prudent manner. No general limits are set for the taking on of business risk, but sensitivities to alternative outcomes are tested and specific limits may be set as a result.

6.4 CHARGES AND EXPENSES
The basis of apportionment of expenses is regularly reviewed for equity and varies according to category of expense.

The expense agreement described in paragraph 6.1(B) above sets out the expense arrangements between the Society and the With Profits Fund until 30 June 2020, but may be extended by the Society beyond that date.

(A) Commission, sales and administration expenses
Commission is charged as incurred. For most business, sales expenses, such as marketing costs, are apportioned in accordance with new business volumes at the time.

Administration expenses are apportioned in accordance with numbers of policies administered within broad policy types.

(B) Guarantees and options
At 30 June 2005 the Society calculated the expected cost of guarantees and options to be paid in the future, and associated funds with the same value to meet these costs from the capital in the With Profits Fund. Since then the Society has regularly assessed the value of these funds, reducing them by the cost of guarantees and options paid since 1 July 2005. At each assessment point, if the value of the funds were lower than the expected cost of guarantees and options, the Society made deductions from Asset Shares to cover the difference. Where the Society considered it was prudent to do so a refund was made. From the 2014 bonus declaration the accumulated impact on Asset Shares was zero and we will no longer be making deductions in this way.

Following closure of the With Profits Fund to new business on 31 January 2015 any change in the expected cost of guarantees and options will be included in the assessment of the adjustment to investment returns described in 6.1(B).

(C) Investment management services
Investment management services are provided by Legal & General Investment Management Limited, a wholly owned subsidiary of Legal & General Group, and certain external fund managers.

Investment expenses are apportioned to the asset classes from which they arise, acting to reduce the achieved investment return (net of expenses) for the asset class. Prior to 1 July 2007 these expenses were generally incurred at cost. With effect from 1 July 2007 fees payable to Legal & General Investment Management Limited are based on a scale of charges, which varies by asset class and the nature of the investment management services provided, as set out in an agreement between the Society and Legal & General Investment Management Limited. These fees have been set by reference to typical market fees for the investment management services.

Where services are provided that are in addition to those specified in this agreement then additional fees may be payable.

Arrangements for the provision of investment management services are regularly reviewed.

(D) Exceptional expenses
Exceptional expenses borne by the With Profits Fund, such as those arising from the development of a new administration system, are charged to specific relevant product lines, or across the With Profits business as a whole, or to the Inherited Estate.

For a given exceptional expense the Board makes a judgement as to the appropriate charging method, taking into account which classes of business led to the expense or are expected to benefit from the expenditure.

(E) Outside purchases
Where expenses are incurred due to the purchase of goods or services from a supplier outside the With Profits Fund the Society aims to achieve competitive commercial terms on behalf of With Profits Policyholders.

Where the supplier is part of the Legal & General Group then the goods or services may be provided either at cost or, as is the case for investment management services as described above, at no greater than typical market rates. Where goods or services are provided at greater than cost then, either there are advantages to With Profits Policyholders arising from these alternative arrangements, or the impact on With Profits Policyholders is not expected to be material.

Occasionally out-sourced services are purchased. The duration and review of such arrangements are individually negotiated.
Explicit deductions and charges
Calculations of bonus affordability have regard to the level of explicit deductions made from policies. These explicit deductions therefore act to determine the relative levels of benefits within a group. The overall level of benefits for a group has regard to the apportionment of incurred expenses and other experience to the group.

Explicit deductions are as described in policy literature. Explicit charges for mortality and sickness benefits are applied to some products. These charges are generally proportional to the amount at risk. The explicit charging rate per unit of cover is generally dependent on an assessment of the probability of a claim being made, and so may vary by, for example, the age of the life assured.

6.5 MANAGEMENT OF THE INHERITED ESTATE
With Profits Policies had no expectation of any distribution from the Inherited Estate while the With Profits Fund remained open to new business.

Following closure of the With Profits Fund to new business on 31 January 2015, the Board will consider annually whether part of the Inherited Estate should be distributed to With Profits Policyholders. In adverse circumstances this may result in a deduction from investment returns in order to increase the value of the Inherited Estate. The amount and timing of any distribution from or deduction to increase the Inherited Estate shall be determined by the Board. The Board will do this considering the interests of all With Profits Policyholders and the requirements of the With Profits Fund in accordance with the Overriding Principles and wider business needs. When we calculate bonus rates each year we may adjust the investment return that we use up or down to reflect the distribution of Inherited Estate.

The size of the Inherited Estate is managed having regard to projections of the future financial position of the With Profits Fund. The Society aims to maintain an Inherited Estate which allows it to achieve its purposes as described in section 5.5.

The investment strategy in respect of the Inherited Estate has regard to Overridding Principle 4.3(A) and the aim to maintain sufficient capital resources to allow some freedom in the determination of the asset mix used in the calculation of Asset Shares.

The size of the Inherited Estate can be increased (reduced) by, among other things:
(A) reducing (increasing) the value of benefits to With Profits Policyholders;
(B) reducing (increasing) the transfer to the shareholders in respect of With Profits business;
(C) longer term, increasing (reducing) the profits from Non Participating With Profits business; or
(D) adjusting the investment returns used to calculate Asset Shares.

The Society uses the Inherited Estate so as to seek to achieve the aims set out in section 5.5. Currently, the Inherited Estate is used primarily to:

- Provide flexibility in investment management.
- Enable policy benefits to be smoothed by absorbing mismatches between income and outgoings.

In addition, there are certain other circumstances where the Inherited Estate is currently used by the Society to meet certain expenses (see section 6.1(B)), additional liability to tax in respect of the transfer to shareholders (see section 6.1(B)), certain exceptional expenses (see section 6.4(D)) and other permitted costs.

In an extreme situation, the Board would consider, on the advice of the Chief Actuary, whether it was necessary for the Society to provide additional support for its capital requirements from its shareholder funds, and the terms of any such support.

If the Board judged that the Inherited Estate was, or was likely to become, inappropriately small it may, after receiving advice from the With Profits Actuary, increase or introduce deductions from policies in order to aim to increase its size. This would have the effect of reducing total With Profits Benefits.

6.6 VOLUMES OF NEW BUSINESS
The With Profits Fund ceased writing new business on 31 January 2015. Only increases to existing Pension Policies and new members to existing Group Personal Pension Schemes, where allowed for in the Policy terms and conditions, can be accepted after that date. Regular premiums in payment at the date of closure will also continue to be accepted.

6.7 EQUITY BETWEEN THE WITH PROFITS FUND, SHAREHOLDERS AND POLICYHOLDERS
The shareholders currently receive no more than one-ninth of the aggregate of distributions to With Profits Policyholders in advance of surplus and the cost of bonus. Currently, shareholders receive about 10% of Distributed Surplus. Guaranteed additions do not constitute bonus for this purpose.

The Practices, described in section 6.1(B), of applying expense caps and of limiting deductions from Asset Shares in respect of shareholder transfer plus any additional tax, act systematically to reduce the Inherited Estate.

6.8 CONTRACTUAL MINIMUM ADDITION (CMA)
(A) Background
At the beginning of each calendar year, the Society will announce a rate of Contractual Minimum Addition (CMA) in respect of Eligible With Profits Contracts.

The rate will then apply to those contracts for the coming year only. No entitlement to CMA for any year shall arise until the rate for that year has been announced.

The Society may and would normally expect to declare an Annual Bonus in addition to the CMA as at the end of each year.

CMA is not a bonus, and so does not generate a transfer to shareholders. The introduction of CMA in 1995 enabled the amount deducted from Asset
Shares in respect of the transfer to shareholders to be reduced, by reducing the amount of the additions to policies which generates a transfer to shareholders.

(B) Rate of Contractual Minimum Addition
The rate of CMA up to and including 1997 was calculated as 80% of the dividend yield on the FTSE Actuaries All-Share Index averaged over the three month period ending on 30 November of the previous year (net of tax borne on dividends in the case of Life business) subject to a maximum rate of CMA of 4% (Life) or 5% (Pensions).

Following a material change to the taxation of dividends of shares, the rate of CMA from 1998 to 2005 inclusive was calculated as 90% of the net dividend yield on the FTSE Actuaries All-Share Index averaged over the three month period ending on 30 November of the previous year (80% in the case of Life business) subject to a maximum rate of CMA of 4% (Life) or 4.5% (Pensions).

Following material changes in relevant securities markets, the rate of CMA from 2006 will be calculated as the lowest of:

a) 90% of the net dividend yield on the FTSE Actuaries All-Share Index averaged over the three month period ending on 30 November of the previous year (80% in the case of Life business);

b) 40% of the FTSE Actuaries UK Gilt 15 Year Yield Index averaged over the three month period ending on 30 November of the previous year (32% in the case of Life business); and

c) 4.5% (4% in the case of Life business).

It is not guaranteed that the current formula will be continued.

(C) Changes to Contractual Minimum Addition
The Society reserves the right to vary the CMA formula in respect of future annual announcements of CMA rates.

For example, the Society will reconsider the formula in the context of material changes, either in relevant taxation legislation or in relevant securities markets, in the UK or elsewhere.

If changes or developments make the current formula inappropriate, the Society would expect to amend it to whatever, in its opinion and as advised by the With Profits Actuary, was an appropriate substitute in the new circumstances.

(D) Application of Contractual Minimum Addition
The rate of CMA will be applied to the average number of With Profits units standing to the credit of the policy throughout the year in order to create a number of additional units.

For claims arising during any calendar year, the number of additional units to be credited will be calculated on a proportionate basis, using the rate announced for that year, in respect of the period from the previous 31 December to the date of claim. The CMA will not apply to Initial Units, which are credited under certain contracts.

The rate of CMA will be available from the Society from the beginning of each year and will be advised to existing Eligible With Profits Policyholders in their benefit statements. Any change in the formula used will be reported upon in the Principles and Practices of Financial Management or in any equivalent publication at the relevant time.

6.9 CONTRACTUAL ANNUAL INTEREST (CAI)
The terms of certain With Profits Policies provide for a non discretionary Contractual Annual Interest to be added to the value of the policy each year until a specified Contractual Point. This is a non discretionary addition to policy benefits to be paid if the benefits are taken at a Contractual Point. The rate of Contractual Annual Interest awarded depends on the year in which the contributions or premiums were paid into the policy and is set out in the terms on which that particular premium or contribution is made. Contractual Annual Interest is not paid to a policy in addition to any bonus declared on such policy. It is rather a minimum level of return guaranteed to eligible Policyholders on certain of their premiums/contributions and is taken into account by the Society when declaring any bonuses. The Society has not written any new policies providing for Contractual Annual Interest to be paid since 1994.
7 GLOSSARY.

ACCUMULATING WITH PROFITS POLICY
A With Profits Policy which has a readily identifiable current benefit, whether or not this benefit is currently realisable, which is adjusted by an amount explicitly related to the amount of any premium payment and to which additional benefits are added in respect of participation in profits by additions directly related to the identifiable current benefit, or a policy with similar characteristics.

ACCUMULATION UNITS
Units under a Unitised With Profits policy other than Initial Units.

ACTUARY
The Actuary appointed by the Board for that purpose.

ADJUSTED INVESTMENT RETURNS
The investment return adjusted to reflect the distribution of the Inherited Estate.

ANNUAL BONUS
Sometimes referred to as Reversionary Bonus, a discretionary, variable addition to policy benefits by way of bonus, applied before payments are made from the policy and before a switch out of Unitised With Profits, which, once added, cannot be withdrawn for benefit payments at contractual points. For Way Ahead policies Annual Bonus may act to reduce premiums due under the policy rather than to increase policy benefits.

ARTICLES OF ASSOCIATION
The Articles of Association of the Society as amended from time to time.

ASSET SHARES
The calculation of historical and/or projected Asset Shares is one of the methods employed in formulating bonus proposals. Asset Shares are calculated by assessing the premiums received net of payments to Policyholders, expenses and other deductions (for example, the transfers to the shareholders) plus any attributed share in profits or losses arising from other business in the With Profits Fund. These sums are then accumulated with Adjusted Investment Returns, allowing for tax (including an allowance for tax in relation to unrealised capital gains or losses).

BOARD OR BOARD OF DIRECTORS
The Board of Directors of the Society, except where explicitly stated otherwise.

CAI
An abbreviation for Contractual Annual Interest.

CHIEF ACTUARY
The Actuary appointed to perform the Actuarial Function defined in the supervision manual of the Regulator.

CMA
An abbreviation for Contractual Minimum Addition.

COMMITTEE
References to any Committee shall include references to any successor Committee from time to time.

CONTRACTUAL ANNUAL INTEREST (CAI)
A non discretionary addition to policy benefits, (other than Contractual Minimum Addition), which, once added, cannot be withdrawn for payments at Contractual Points.

CONTRACTUAL MINIMUM ADDITION (CMA)
A non discretionary variable addition to policy benefits, the rate of which is announced at the beginning of each calendar year in respect of Eligible With Profits Contracts.

CONTRACTUAL POINT
With Profits Policies generally provide a combination of smoothing and guaranteed minimum benefits under certain conditions, for example at maturity, normal retirement or death. Within this document such payments are referred to as payments at Contractual Points.

CONVENTIONAL WITH PROFITS POLICY
A With Profits Policy which is not an Accumulating With Profits Policy.

DISTRIBUTED SURPLUS
The aggregate of distributions to With Profits Policyholders in advance of surplus and the cost of bonus, together with the associated transfer from the With Profits Fund to the shareholders.

ELIGIBLE WITH PROFITS CONTRACTS
Contracts eligible for Contractual Minimum Addition, namely:

Pensions business
• Conventional Buy Out Plan taken out in 1995
• All Unitised With Profits contract types from 1 January 1995 to 13 June 1998 inclusive (Accumulation Units only).

Life assurance business
• Capital Investment Portfolio contract types from 1 January 1995 to 27 July 1997 inclusive
• New Savings Plan and Regular Savings Plan contract types from 1 January 1995
• Flexible Protection Plan contract types from 1 January 1995

FINAL BONUS (Also known as “Terminal Bonus”) A bonus which may be added when payments are made from a With Profits Policy. For Unitised With Profits Policies such a bonus may also be added on switching out of Unitised With Profits or when units are extinguished to cover explicit charges.
INHERITED ESTATE (Also known as the “With Profits Estate”)
The excess of assets maintained within a With Profits Fund over and above the amount required to meet liabilities (including liabilities which arise from the regulatory duty to treat customers fairly in setting discretionary benefits).

INITIAL UNITS
A form of unit under a Unitised With Profits policy, generally credited in order to apply an initial charge to a policy or to increments paid into a policy. Lower bonuses and/or Contractual Annual Interest normally apply to such units than apply to Accumulation Units.

INTERIM BONUS
A bonus which may be added when payments are made from a With Profits Policy in respect of any period for which an Annual Bonus rate has not been declared. For Unitised With Profits Policies such a bonus may also be payable on switching out of Unitised With Profits.

LEGAL & GENERAL GROUP
Legal & General Group Plc and its subsidiaries.

MARKET VALUE REDUCTION
A reduction applied to the sum payable on a payment or a switch from certain Accumulating With Profits Policies under certain circumstances.

MARKET VALUE REDUCTION FACTOR (MVRF)
A factor applied to effect a Market Value Reduction.

NON PARTICIPATING POLICY
A policy issued by the Society which is within the With Profits Fund but which is not a With Profits Policy.

OVERRIDING PRINCIPLES
The principles set out in section 4 of this document.

PAYOUT RATIO
The benefit payment under a With Profits Policy divided by the Asset Share.

POLICYHOLDERS
As the context admits, some or all of those who hold policies issued by the Society.

PRACTICES
The practices of financial management of the Society’s With Profits business. At the effective date of this document, these were the practices set out in section 6 of this document.

PRINCIPLES
The principles set out in sections 4 and 5 of this document.

REGULATOR
The Prudential Regulation Authority and/or the Financial Conduct Authority (as the context requires) or any subsequent Regulator.

RISK RATES
Factors used to determine the explicit charges to be applied to policies in respect of life insurance and sickness cover provided, expressed as a charge per pound sterling of cover provided.

RISK TRANSFER AGREEMENT
This is an agreement which transfers the economic risk and reward from the Society shareholder to ReAssure Limited.

SHAREHOLDER
Legal and General Assurance Society Limited shareholder.

SOCIETY
Legal and General Assurance Society Limited.

SPECIMEN POLICY
A policy constructed to represent the portfolio of business for which bonus affordability is being assessed.

TEMPORARY BONUS
An additional bonus which may be added to annuity payments from With Profits Annuities for a limited period.

UNITISED WITH PROFITS
A form of Accumulating With Profits Policy under which the readily identifiable current benefit is expressed in the form of units.

WITH PROFITS ACTUARY
The Actuary appointed to perform the With Profits Actuary Function defined in the supervision manual of the Regulator.

WITH PROFITS ANNUITY
A With Profits Annuity contract launched in 2000, the annuity payments from which may be increased by Annual Bonus and Temporary Bonus. With Profits Annuity benefits had been provided under some earlier contracts, but with a different bonus structure.

WITH PROFITS BENEFITS
The benefits payable from a With Profits Policy. For Unitised With Profits Policies these include the sum available to purchase units in other funds on switching out of Unitised With Profits.

WITH PROFITS POLICIES
With Profits Policies issued by the Society. A “With Profits Policy” is a contract falling within a class of long-term insurance business which is eligible to participate in any part of any established surplus.

WITH PROFITS POLICYHOLDERS
Policyholders who hold With Profits Policies.

WITH PROFITS FUND
The With Profits section of the Society.