

Ecclesiastical Life Limited

PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT



1 March 2011

ECCLESIASTICAL LIFE LIMITED PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT COMPLIANCE REPORT TO WITH-PROFITS POLICYHOLDERS 1 JANUARY 2010 to 30 NOVEMBER 2010

1. INTRODUCTION

Ecclesiastical Life Limited (ELL) first published its Principles and Practices of Financial Management (PPFM) in May 2004. This was revised on a number occasions after that date, with all changes notified to policyholders. A consumer friendly version of the PPFM, "How We Manage Our With-Profits Business," was introduced from 31 December 2005.

The with-profits fund was transferred to Homeowners Friendly Society Limited (HFSL), trading as Engage Mutual (Engage), at 30 November 2010. This report covers compliance with the obligations in the PPFM for the portion of 2010 that the fund was managed by ELL, 1 January 2010 to 30 November 2010 ("the period").

Copies of the PPFM were available at all times during the period covered by this report. The PPFM in place at 30 November 2010 was adopted by Engage and the current version is available on their website at <http://www.engagemutual.com/engage-mutual-ell-with-profits/>. When reading this report, you may find it useful to refer to the PPFM, in particular the Glossary.

2. STATEMENT OF COMPLIANCE

It is the Board of Directors' opinion that we complied with the obligations relating to the PPFM throughout the period 1 January 2010 to 30 November 2010.

The Board confirms that:

- (a) the exercise of discretion in the conduct of ELL's with-profits business was appropriate and applied in accordance with the PPFM, and
- (b) any competing or conflicting rights, interests or reasonable expectations of ELL's policyholders were addressed through the application of the PPFM. In doing so, we maintained fairness between different categories of policy and policyholder and between policyholders and the shareholder.

In making this declaration we have taken into account:

- (a) advice from our With-Profits Actuary on compliance with the PPFM and discretion exercised throughout the period. A statement from him is attached to this report,
- (b) independent judgement from the Independent Expert, on our compliance with the PPFM throughout the period,
- (c) the Directors' overall assessment of the business, and
- (d) materiality of individual aspects of compliance.

The main reasons for believing we can make this statement are covered below.

3. GOVERNANCE

In common with all with-profits funds, ELL was required to maintain governance arrangements during the period designed to ensure that, in the conduct of our with-profits business, we complied with, maintained and recorded our PPFM. In addition the management of the fund was governed by a Scheme sanctioned by Court on 28 July 2003.

The Board of ELL took overall responsibility for the management of the with-profits fund during the period and ensuring that compliance with the PPFM was maintained. In doing so, advice was taken from the With-Profits Actuary, particularly on key aspects of the exercise of discretion in

management of the fund. This role was fulfilled by Andrew Sanders throughout the period covered by this report. The With-Profits Actuary is required to report annually to policyholders on the management of the fund and his statement is attached to this report.

In addition, all key decisions were reviewed by an appointed Independent Expert, Christopher Critchlow, who has provided comments on compliance with the PPFM and the fairness of treatment of policyholders.

Ongoing compliance of the PPFM was considered at each Board meeting of ELL during the period, with an updated report from the Actuarial Function Holder of ELL on all relevant requirements.

4. PAYOUTS AND BONUS RATES

Payouts made from the with-profits fund during the period reflected asset shares, subject to meeting any guaranteed benefits and allowing for smoothing in accordance with the PPFM. The calculation of asset shares was consistent with the PPFM and no changes to methodology were made during 2010.

All bonuses were set following advice from the With-Profits Actuary and confirmation from the Independent Expert that they were compliant with the PPFM.

Regular bonus rates for conventional policies declared for the 31 December 2009 distribution applied on an interim basis throughout 2010.

The regular bonus rate for With Profit Bonds remained at the same level throughout the period at a rate of 2.5% per annum (reduced from 3% in 2009 to reflect lower income yields on the underlying investments).

The bonus rate for deposit administration schemes during 2010 was declared after the transfer of the fund to Engage. An interim rate of 5% (equal to the level declared for 2009) applied during the period. The guaranteed minimum rate applicable for 2010 had previously been declared as 0%.

The final bonus rates that applied to payouts on conventional policies throughout 2010 were set with the expectation that the target ranges specified in the PPFM would be met for maturities. Final bonus rates for conventional with-profits contracts remained at the same level throughout the year, based on a review in October 2009.

With Profit Bond final bonus rates and Market Value Reduction (MVR) factors were reviewed quarterly and amended in August and November 2010.

Surrender values were set with the aim of meeting the target ranges, where necessary by applying MVRs to some types of policy on surrender. Other than for With Profit Bonds, as mentioned above, MVRs remained unchanged throughout the period.

In setting final bonus rates and MVRs we followed the approach set out in the PPFM and differentiated between classes and generations of policy in a reasonable and proportionate manner.

5 INVESTMENT POLICY

The investment policy of the with-profits fund remained unchanged during the year, and in accordance with the PPFM.

The overall gross asset mix of the fund at the start and end of the period is shown in the table below.

Investment Class	Percentage of Fund At 1 January 2010	Percentage of Fund At 30 November 2010
Equities*	57%	58%
Property	4%	3%
Fixed Interest	34%	35%
Cash	3%	2%
Derivatives	2%	2%
TOTAL	100%	100%

* The effective exposure of the fund to equities was reduced by the use of derivatives. This is discussed in more detail below.

Equity markets continued to be volatile during the first half of the year though index levels rose steadily after the mid-year. Against this background, the fund maintained a fairly constant level of derivative cover giving protection against falls in the equity market. At the end of the period the overall impact of the derivative holdings was to reduce the effective investment in equities (including property) from 61% to 37% of the fund.

The fund has been managed for a number of years so that different asset mixes applied to different types of policy. These had been communicated to policyholders in bonus notices. In January 2010 the PPFM was amended to identify separate benchmark ranges for the asset mix of the different policy types to more clearly set out the current practice.

The benchmark asset allocation limits in the PPFM were further amended in September 2010 to reflect a management action approved by the Board during the period that allowed lower minimum levels and higher maximum levels of equity investment than was previously the case.

The asset mix remained within the benchmark ranges specified in the PPFM throughout the period. Benchmark asset allocations were monitored monthly and exposure to corporate bond and loan counterparties monitored quarterly.

The investment strategy was reviewed by the Board during the year. The review reiterated the existing aim of managing the with-profits fund to ensure that it is able to meet its own capital requirements (on both Pillar 1 and Pillar 2 bases) except in extremis.

Assets held in excess of those backing asset shares were invested in the same mix as the overall fund throughout the period.

6 BUSINESS RISK

Risks were monitored regularly during the year. No significant new risks were undertaken during the year.

7 EXPENSES AND CHARGES

Expenses continued to be charged to the with-profits fund in line with the Scheme, as summarised in Appendix B of the PPFM. Aggregate charges and expenses applied to asset shares were also consistent with the PPFM and the charges borne by the fund overall. A review that had taken place during 2009 had confirmed charges to be broadly in line with industry expense levels.

8 INHERITED ESTATE

The amount of the inherited estate continued to be monitored and the level remained within the broad target range set out in the PPFM. In September 2010 the PPFM was amended to alter the definition of the target maximum inherited estate, so that it was measured by reference to the inherited estate net of costs of guarantees.

The inherited estate was not used for any new purposes in 2010. During the period no deductions were made from asset shares to allow for the potential use of ELL's capital to provide financial support.

Volumes of new business in the with-profits fund were low during the period and the decision was taken to close the fund to new business immediately after the transfer to Engage on 30 November 2010.

9 CHANGES TO PPFM

Changes were made to Practices in the PPFM on two occasions during the period.

On 27 January 2010 the application of benchmark asset allocation limits by product class was clarified; prior to that date the PPFM disclosed only the aggregate fund limits.

On 16 September 2010 changes were made to the benchmark asset allocation limits to reflect a management action approved by the Board, as referred to in Section 5 above. At this date a change was also made to the definition of target inherited estate (see Section 8 above) and two principles, relating to contingent risks that no longer applied, were removed.

With-Profits Actuary's report to with-profits policyholders for the period 1 January 2010 to 30 November 2010

As With-Profits Actuary to Ecclesiastical Life Ltd ("ELL") in respect of its with-profits business I am required to report to the with-profits policyholders every year on whether, in my opinion, the with-profits business of ELL has been managed over the year in a way that takes their interests into account in a reasonable and proportionate manner.

Policyholders should not rely solely on the information contained in this report when making financial decisions and this report does not represent financial advice.

ELL has provided me with information about the management of the with-profits fund during the period 1 January 2010 to 30 November 2010 (the "2010 period"). I have also had access to the Board of ELL to discuss matters relating to with-profits business. In preparing this report I have taken account of relevant rules of the Financial Services Authority and relevant guidance notes of the actuarial profession. I have also complied with the Technical Actuarial Standard R for reporting actuarial information, as issued by the Board for Actuarial Standards. In my opinion, the annual report by ELL to its with-profits policyholders and the discretion exercised by ELL in respect of the 2010 period may be regarded as having taken the interests of ELL's with-profits policyholders into account in a reasonable and proportionate manner.

Andrew Sanders
With-Profits Actuary
February 2011
Towers Watson Limited
Watson House
London Road
Reigate
Surrey
RH2 9PQ

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Beaufort House, Brunswick Road,
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