

Ecclesiastical Life Limited

PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT



16 September 2010

Principles and Practices of Financial Management (PPFM) applicable to the with-profits fund of Ecclesiastical Life Limited (ELL)

1. Introduction

This PPFM is a document describing how ELL runs its **with-profits fund**. It is split into Principles and Practices that ELL follows when managing its **with-profits fund**. The Principles within the PPFM describe enduring statements of the overarching standards ELL adopts when managing the **with-profits fund**, taking into consideration the business model used by ELL in meeting its duties to **with-profits policyholders** and the longer-term changes in the business and economic environment.

The Practices are more specific statements of the current approach of managing the **with-profits fund** taking into account the shorter-term changes in the business and economic environment, new rules and regulations, and new methods in the life insurance industry.

We will change our PPFM only if the change is justified by the need to respond to changes in the business, economic, or regulatory environment to protect the interest of **with-profits policyholders**, or to change ELL's Practices better to achieve its Principles. Also, we will change our PPFM if it is necessary to correct an error or omission, or to improve the clarity or presentation of the PPFM without materially affecting its substance.

The **Board** of Directors at ELL will certify to the **FSA** each year that the **with-profits fund** has been managed in accordance with this PPFM.

You will find an explanation of the various expressions shown in bold in this document in the glossary in Appendix A.

Consumer Friendly PPFM (“CFPPFM”)

A consumer friendly version of ELL's PPFM (CFPPFM) is also available for ELL's current and potential **with-profits policyholders**. The CFPPFM describes the most important information from this PPFM, expressed in clear and plain language. In the event of conflict arising between the CFPPFM and the PPFM, the PPFM takes precedence over the CFPPFM.

2. Overarching Principles

2.1 ELL will at all times endeavour to:

- meet all guaranteed obligations in all reasonably foreseeable situations
- treat all policyholders fairly, taking into account any conflicting interests between them
- comply with the requirements of the **regulator**, including meeting appropriate tests of **solvency** and **capital adequacy**.

2.2 In the event of a conflict arising as a result of the application of any one or more of the Principles, these overarching Principles will take precedence.

2.3 In the event of a conflict arising between these overarching Principles the **Board** will decide the precedence at the time of the conflict.

3. Amount payable under a **with-profits policy**

The guide to the amount payable under a **with-profits policy**

Principles

3.1 ELL aims to provide **with-profits policyholders** with a fair return that reflects the actual experience applicable to each generation and class of **with-profits policy**, subject to the smoothing Principles described in section 6.

3.2 When applying the methods that ELL uses to determine the amount payable to **with-profits policyholders** ELL may use approximations. Where appropriate experience data is not available ELL uses assumptions and parameters which in the opinion of the Actuary are broadly reflective of experience.

3.3 The **Actuary** regularly reviews the methods and assumptions including the parameters used. Any proposed material changes are referred to the **Board** for its approval.

3.4 ELL might change historical assumptions or parameters relevant to the methods if it can be shown that the changed assumptions or parameters are a more accurate reflection of the actual experience of the **with-profits fund** or the applicable generation and class of **with-profits policyholder**, and if changing the assumptions or parameters has a material impact on the results of applying the methods.

Practices

3.5 The guide to determining the **amounts payable** to **with-profits policyholders** is currently defined to be the **asset share**.

3.6 The aim in the long term, in determining **payouts** for maturing **with-profits policies**, is to return as a group, on average 100% of asset shares. The **amounts payable** on maturity in any year, or to any particular **with-profits policyholder** may be more or less than 100%, due to the effects of smoothing, guarantees, and grouping of policies.

3.7 The aim in the long term, in determining **payouts** for surrendering **with-profits policies**, is to return as a group, on average 100% of **asset shares**. The amounts payable on surrender in any year, or to any particular **with-profits policyholder** may be more or less than 100%, due to the effects of smoothing, guarantees, the grouping of policies and any deductions necessary to protect the interests of remaining policyholders.

3.8 The aim in the short term is to ensure that, subject to meeting any **guaranteed benefits, payouts** for at least 90% of pension endowments and whole of life policies fall in the range 65% to 135% of **asset shares** while **payouts** for at least 90% of other policies fall in the range 80% to 120% of **asset shares**.

3.9 The target payout range mentioned in the paragraph above applies to all our **with-profits policies** except **Deposit Administration** business. For this product the maturity payout cannot reasonably be compared with a calculated **asset share** and therefore target ranges do not apply to the **payouts**. Sections 4, 5 and 6 provide more details on the payout approach for this group of policies.

3.10 ELL keeps documentation reflecting the methods used and assumptions made to determine **payouts** since 1997 and records of recommendations to the **Board** prior to 1997.

3.11 The main assumptions or parameters in the **asset share** calculations are determined by regular investigations into the experience of the **with-profits fund**, except for the expense deductions, which are based on those specified in the **Scheme** (see paragraph 3.16). The approximations allowed when applying assumptions or parameters across generations and classes of policy are in line with the overall aim of sharing the experience of the **with-profits fund** between **with-profits policyholders**.

3.12 Currently **asset shares** are calculated using averaging across product class, policy sizes and across ages of **with-profits policyholders**.

3.13 Where reliable data can be obtained that materially alters the results of the calculations the degree of approximations used is low.

3.14 Where methods or parameters used in the calculations are considered to require changes, the **Actuary** completes a comparison with current methods and parameters and reports on the reasons for changes and results to the **Board** for approval.

3.15 The **equity backing ratios** currently applied to **former ALA with-profits policies**, With Profit Bond policies and **Deposit Administration** business are different from the **equity backing ratios** applied to other **with-profits policies**. See paragraph 7.10 for further information on how these might vary.

3.16 The basis of the expenses chargeable to the **with-profits fund** with effect from 31 July 2003 is set out in paragraph 19 and Schedule 2 of the **Scheme** (see Appendix B). The overall expense deductions in the **asset share** calculations, across all policies, reflect the total expenses chargeable to the **with-profits fund**. The expense deductions in the **asset share** calculations for each **with-profits policy** are applied as a proportion of either the premium or the benefit amount (**sum assured** plus current bonus) for that particular policy. These proportions are set to reflect a fair contribution to expenses from each **with-profits policy** and may be either greater or smaller amount than the amount specified in the **Scheme**.

3.17 A deduction in respect of tax is made from the **with-profits fund** as if it were a separate mutual company in accordance with the **Scheme**. The tax deduction in the **asset share** calculations is consistent with this treatment.

3.18 The mortality charges deducted in the **asset share** calculations are based on a best estimate assessment of the **mortality cost** arising on the **asset shares** in question.

3.19 An annual deduction from **asset shares** may be made for use of ELL's capital.

3.20 When calculating **asset shares** ELL may make deductions for the assessed cost (determined on assumptions ELL considers appropriate) of providing guarantees on ELL's **with-profits policies**. These deductions may vary by product type. Currently no such deduction is made. ELL may also acquire derivative instruments to manage the cost of guarantees in line with the Principles in paragraph 7.3. These instruments will form part of the pool of assets backing **asset shares**, and the change in the value of the instruments will be reflected in the investment return credited to **asset shares**. The instruments will typically be chosen to provide protection in adverse investment conditions; if such conditions do not arise, the instruments will expire and the effect will be to reduce the credited return.

3.21 Periodically the Board reviews the appropriateness of the level of the charges specified in paragraphs 3.16 to 3.20 and may, at its discretion, make additional deductions to **asset shares** to ensure that ELL maintains adequate financial strength. The consistency of these deductions with actual and intended investment policy is checked.

3.22 Partial withdrawals are permitted on With Profit Bond policies and these are guaranteed to be free from **market value adjustments** under certain conditions as set out in policy conditions. The calculation of **asset shares** takes account of withdrawals and **market value adjustment** guarantees where applicable.

3.23 Additions or deductions in the **asset share** calculations are made in respect of **miscellaneous profits or losses** that are generated from the normal day to day activities of the **with-profits fund** and deemed to be allocated to asset shares. This adjustment is a percentage of **asset share** for all policies.

3.24 Additions or deductions in the **asset share** calculations in respect of extraordinary **miscellaneous profits or losses** will only be made after specific **Board** agreement. This adjustment may be a percentage of **asset share** for groups of policies.

4. Approach to setting regular bonus rates

Principles

4.1 ELL's general aims in setting **regular bonus rates** for all classes of **with-profits policy** except **Deposit Administration** are:

- to distribute a proportion of the investment income earned by the assets backing the **with-profits policyholder statutory liabilities** in a smoothed manner
- to reflect the **surplus** generated by policies
- to target a substantial **final bonus** element in maturity payments.

4.2 ELL's general aim for **Deposit Administration** is to reflect the **surplus** generated by the group of **Deposit Administration** policies.

Practices

4.3 In the event of a significant difference in the bonus expectations between a range or generation of policies, and if ELL considers that a single **regular bonus** rate would violate the overarching Principles, consideration would be given to setting up a new **bonus series**.

4.4 **Regular bonus** rates are currently set by reference to a sustainable level based on expected investment income according to the future investment strategy, and the aim is to target a substantial **final bonus** element in maturity payments. This calculation is subject to the smoothing described below in section 6 and the overall **solvency** of the **with-profits fund**.

4.5 Currently separate **regular bonus** rates are declared for Life policies, 55 series Pension policies, 56 series Pension policies, three series of **former ALA with-profits policies**. With Profit Bond policies, **Deposit Administration** policies and other pension policies. **Deposit Administration** business receives a guaranteed **regular bonus** of such rate as is notified plus a discretionary regular bonus rate. For With Profit Bond policies a single regular bonus rate is declared for bonus on **sum assured** and bonus on previously declared regular bonus. For all other classes of policy, separate rates of **regular bonus** are declared to apply to **sum assured** and previously declared **regular bonus**.

4.6 ELL expects to reset **regular bonus** rates once a year. The **regular bonus** rate for With Profit Bond policies may be reset more frequently if there is a significant change in economic circumstances. The **regular bonus** rates for **former ALA policies** are currently set once every three years.

4.7 There is no maximum amount by which **regular bonus** rates may be changed.

4.8 If no significant change in **regular bonus** rates is anticipated at the next declaration, **interim bonus** rates are normally set equal to the previously declared **regular bonus** rates applicable to policies in the same **bonus series**. If a significant change in **regular bonus** rates is anticipated at the next declaration, **interim bonus** rates may reflect partially or fully the anticipated change in **regular bonus** rates.

5. Approach to setting final bonus rates

Principles

5.1 Final bonus rates are set so that the **payouts** for **with-profits policies** reflect the Principles set out in section 3, subject to the smoothing Principles set out in section 6. In addition, the following Principles are followed in setting **final bonus** rates:

- separate scales of **final bonus** rates are declared for different classes of **with-profits policy** where this is necessary to provide policyholders with a fair return
- within a particular class, **final bonus** rates may vary by duration since commencement of the policy, and any other factor considered necessary to maintain fairness between different groups of policyholders
- there is no restriction on the company paying **final bonus** on some categories of policies whilst at the same time not on others, or on the application of **market value adjustments**.

Practices

5.2 Final bonus rates are set by reference to the Practices set out in section 3 and section 6. Different **final bonus** rates are set according to class of business where the **asset share**, or the relationship between the **asset share** and the **accumulated guarantees**, gives rise to materially different results.

5.3 Where **final bonus** scales are currently shared between classes of policy this does not preclude a change at any time to separate scales.

5.4 The same **final bonus** scale is used for maturity and death claims except where the policy conditions define the death benefit in terms other than a guaranteed **sum assured**. Within a cohort of a class of business the **final bonus** scale is smoothed over policies with different original terms in line with the smoothing practices described in section 6.

5.5 For life policies **final bonus** on maturity or death is defined as a percentage of **sum assured** plus attaching **regular bonus**. For pension endowments, **final bonus** on maturity or death is defined as a percentage of regular bonus. The **final bonus** on 55 and 56 Series pension policies is expressed as a percentage of the annuity amount plus accrued **regular bonus**. No **final bonus** is paid to **Deposit Administration** policies.

5.6 Final bonus is currently paid on surrender using the same scale as for maturing policies. The **final bonus** percentage is determined by reference to the term from commencement to surrender. The **final bonus** percentage is applied to the surrender value for life policies as well as 55 and 56 Series pension policies. For pension endowments, the **final bonus** percentage is applied only to the surrender value of the accrued **regular bonus**.

5.7 Final bonus rates are reviewed and may be changed annually. If the **final bonus** rates no longer satisfy the Principles set out above as a result of changes in the economic environment, the **final bonus** rates would be reviewed and may be changed more frequently.

6. Approach to smoothing

Approach to smoothing the value of with-profits policies

Principles

6.1 ELL smooths **final bonus** rates in order to reduce the impact of fluctuations in experience, taking into account **guaranteed benefits** and the need to maintain fairness between different groups of **with-profits policyholders**.

6.2 ELL does not take a significantly different approach to smoothing depending on the type of claim arising from **with-profits policies**.

6.3 ELL intends smoothing to be neutral over time.

6.4 In the shorter-term there is no total scale or **cost of smoothing** to the **with-profits fund** that ELL believes should not be exceeded.

Practices

6.5 ELL aims for smoothing to be financially neutral over the course of an economic cycle.

6.6 ELL aims to ensure an accumulated **cost of smoothing** that does not threaten its ability to demonstrate an adequate **solvency** position or its ability to meet its contractual obligations to policyholders.

6.7 Currently ELL applies different smoothing strategies to different classes of **with-profits policies**. The different classes are regular premium **conventional policies**, **conventional policies** where regular premiums are not being paid, **Deposit Administration** business, With Profit Bond policies, and three series of former ALA with-profits policies.

6.8 The smoothing strategy currently applied for new entrants is the same as that for existing policies.

6.9 For regular premium **conventional policies** ELL aims to limit the differences between maturity **payouts** on similar policies to a maximum of 15% from one bonus declaration to the next. In the event of conflict arising between this aim and the aim for the target ranges described in paragraph 3.8, the aim for the target ranges takes precedence.

6.10 For **conventional policies** where regular premiums are not being paid, smoothing between maturity **payouts** is operated across blocks of policies commencing within a time period where asset levels were broadly similar.

6.11 For **conventional policies market value adjustments** are applied on surrender to achieve the aims described in paragraph 3.8. For surrender **payouts** of **conventional policies** that are within 2 years of maturity, the impact of **market value adjustments** is reduced to ensure a smooth progression from the surrender **payout** to the **guaranteed benefit** payable at maturity.

6.12 For **Deposit Administration** business smoothing is achieved by a discretionary **regular bonus** in addition to the guaranteed **regular bonus**. Smoothing is applied over the entire term of the contract. On surrender **market value adjustments** are applied to achieve the aims described in section 3. **Market value adjustments** are scheme specific.

6.13 For With Profit Bonds, **market value adjustments** are applied on surrender to achieve the aims described in paragraph 3.8. **Market value adjustments** are guaranteed not to apply under certain conditions as set out in policy documents.

6.14 For three series of former ALA **with-profits policies** smoothing is achieved by basing payouts on smoothed **asset shares**. Smoothed **asset shares** are determined as for **asset shares**, except that investment returns earned over the previous two years are blended with a long-term investment return assumption. In the event of conflict arising between this approach and the aim for the target ranges described in paragraph 3.8, the aim for the target ranges takes precedence.

7. Investment strategy

Principles

7.1 The investment objectives of the **with-profits fund** are to achieve a satisfactory investment return on **policyholder assets** subject to being able to meet **guaranteed benefits** with an appropriate level of certainty, taking into account the level of the **inherited estate**, expected strains on the **inherited estate** and past communications made to policyholders.

7.2 ELL does not normally rely on assets outside the **with-profits fund** to maintain ELL's investment strategy for the **with-profits fund** but a proportion of capital in the shareholders' fund may be available to support that investment strategy from time to time.

7.3 Derivative instruments may be used either for the purpose of reduction of investment risk and/or efficient portfolio management. For example **derivative instruments** may be used for reducing mismatches between liabilities and assets where this cannot be achieved by non-derivative assets or where **derivative instruments** may present a more efficient solution.

7.4 There are no constraints on ELL's investment strategy with respect to parts of the **with-profits fund** or between different generations of **with-profits policyholders**, subject to the other investment strategy Principles.

7.5 ELL's **exposure** to individual investment **counterparties** is monitored periodically. Limits on exposure to individual **counterparties** are set taking into account the **with-profits fund's** overall risk appetite and taking into account any limits set by the **Regulator**.

7.6 ELL may have a number of Strategic Investments, being assets that would not normally be traded because of their importance to ELL. These Strategic Investments could include holdings in subsidiary companies and owner occupied properties. Explicit **Board** or **Board** committee approval is required for the **with-profits fund** to trade these assets.

Practices

7.7 ELL may transfer assets permanently to the **with-profits fund** or provide temporary capital support following a review by the **Board** of the required level of assets to support the **with-profits policyholder statutory liabilities** under the future investment strategy.

7.8 ELL's investment strategy is reviewed annually.

7.9 The **with-profits fund** invests in assets appropriate to the nature of the **with-profits policyholder statutory liabilities**.

7.10 As a result of the investment strategy process, benchmark asset allocations are produced. The aim is to ensure that the actual asset allocations remain within the benchmark asset allocation limits. However in certain circumstances, such as movements in investment markets, the actual asset allocations may in the short term move outside the benchmark limits. Taking into account the current financial position of the fund the current ranges for benchmark allocations of the **with-profits fund** are as follows:

Asset type	Lower limit	Upper limit
Equities (including property)	20%	75%
Fixed interest, variable interest, deposits and cash	25%	80%

The asset limits shown above take account of any **derivative instruments** held by the **with-profits fund**.

The asset allocations currently differ by product class. The benchmark asset allocations by product class are:

	Equities (including property)		Other investments (including fixed interest, variable interest, deposits & cash)	
	Minimum	Maximum	Minimum	Maximum
With Profit Bonds	23%	90%	10%	77%
Deposit Administration	10%	55%	45%	90%
Former ALA with-profits policies	15%	70%	30%	85%
Other product classes	20%	80%	20%	80%

The current fixed interest portfolio consists of a range of fixed interest instruments which includes Government Securities, Local Authority Issues, Preference Shares, Other Loans, Permanent Interest Bearing Shares, Overseas Bonds and Corporate Loans and Bonds.

Limits are imposed on the credit ratings of the corporate bond portfolio. ELL currently limits exposure to corporate bonds and loans that have ratings lower than investment grade or have neither implied nor formal ratings to 15% in aggregate of the **with-profits fund**. ELL has processes in place to identify, and report to the **Board**, any breaches of ELL's credit rating limits.

7.11 New or novel investment instruments have to be approved by the **Board** or a committee of the **Board**, on advice from the **Actuary**. The risks and potential rewards of the instruments would be analysed in the context of the **with-profits fund's** investment strategy, the existing assets held, efficient portfolio management principles and the **with-profits policyholder statutory liabilities**. It is envisaged that the Board or committee of the **Board** would approve the new or novel investment instruments if, after considering the above factors, they believe that the benefits associated with the new or novel investment instruments outweigh any increase in risk or cost.

7.12 The **with-profits fund** currently has no Strategic Investments, being assets that would not normally be traded because of their importance to ELL.

8. Business risk

Principles

8.1 The assessment of business risks undertaken in the **with-profits fund** is presented to the **Board** for consideration on a regular basis.

8.2 ELL decides if the **with-profits fund** may undertake a particular business risk by comparing the risks and potential rewards from the business risk against alternative capital market investment opportunities, taking into account any possible benefits of diversification. A business risk may only be undertaken if it is expected to provide the same or higher potential rewards than a capital market investment of similar riskiness, or similar potential rewards as a capital market investment of the same or greater riskiness.

8.3 The arrangements for reviewing and setting limits on the extent of business risks for the **with-profits fund** are undertaken along with the review of the investment strategy and **inherited estate** management strategy. Any limits on the scale of business risks take into account the **with-profit fund's** appetite for risk and its ability to meet the **Regulator's solvency** requirements in the event of an extreme loss arising as a result of taking on that business risk.

8.4 Profits or losses are assessed periodically and are reflected in the guide to the amount appropriate to pay **with-profits policyholders**.

8.5 The risk from all new business sold within the **with-profits fund**, transacted subsequent to the **Effective Date** of the **Scheme** (other than expense risk) is borne by the **with-profits fund** with the exception of any potential mis-selling risks arising subsequent to the **Effective Date** of the **Scheme** which are borne by the **without profit fund** unless otherwise agreed with the **Regulator**.

8.6 All risks, including any cost of investigation, relating to any mis-selling or potential mis-selling in respect of policies sold prior to the **Effective Date** of the **Scheme** will be met from the assets in the **with-profits fund** except for any financial penalties which may be imposed (which will only be allocated to the **with-profits fund** after agreement with the **Regulator**).

8.7 **Former ALA with-profits policies** are excluded from any guarantee or mis-selling costs arising from the **former EIO policies**.

8.8 With the exception of the new business risks and mis-selling risks mentioned above, compensation costs arising from other business risks, such as administration risks, are borne by either the shareholders, the **with-profits fund** or the **without profit fund** depending on which fund stood to benefit from the profits expected from exposure to the business risk.

Practices

8.9 ELL currently does not have any limits on the mix of business sold. This is reviewed on a regular basis.

8.10 ELL intends to set general limits for business risks such that they are proportionate to the sizes of the **inherited estate** and **policyholder assets**.

8.11 The Scheme has removed part of the expense risk from the **with-profits fund** and removed most of the risk associated with the selling of **without profit policies**.

8.12 The Board decides on a case by case basis whether and to what extent and for which policies profits or losses from business risks should be applied to **asset shares**.

9. Charges and expenses

Principles

9.1 ELL applies administration and investment management charges and apportions expenses to the **with-profits fund** in accordance with the expense arrangements set out in paragraph 19 and Schedule 2 of the **Scheme** (see Appendix B).

9.2 Any difference in the aggregate expenses allowed for in the amounts used to guide payouts and the total aggregate expenses attributed to the **with-profits fund** in accordance with the Scheme will be charged to the **inherited estate** or included in **miscellaneous profits or losses** for the period.

9.3 The arrangements regarding administration charges may be reviewed if the level of administration expenses in ELL and in similar firms change by an exceptional amount.

Practices

9.4 The basis of the expense charges on the **with-profits fund** is set out in paragraph 19 and Schedule 2 of the **Scheme** (see Appendix B). Industry levies or other similar costs will be borne by the **with-profits fund** on a proportional basis similar to the method used to calculate the levy or costs or on another fair and equitable basis. The charging of these costs to **with-profits policies** will be subject to approval by the **Board** on advice of the **Actuary**.

9.5 The charges and expenses applied to the **asset share** are consistent with the charges and expenses borne by the **with-profits fund**.

9.6 Due to the nature of the predetermined expense arrangements relating to the **with-profits fund**, expenses will be charged to the with-profits fund, using the agreed formulae, at an amount other than the actual expenses incurred.

9.7 The administration of **Deposit Administration** business is outsourced. The outsourcing agreement is reviewable every five years and may be terminated either by mutual consent with six months' notice as a result of a breach of the agreement or as a result of the insolvency of the outsource provider. For **Deposit Administration** business the charges made to the **with-profits fund** are as described in Appendix B paragraph 4.

9.8 Flexible Investor Policies and Young Persons Investor Policies are structured in units of fixed amounts. For each policyholder the expense charges are based on those set out in paragraph 19 and Schedule 2 of the **Scheme** (see Appendix B) and spread over the policyholder's total number of units.

10. Management of the inherited estate

Principles

10.1 An **inherited estate** is maintained within the **with-profits fund** to:

- enable the fund to smooth benefit payments in line with the Principles outlined above
- meet the cost of **guaranteed benefits** arising on **with-profits policies**
- enable greater investment freedom for the **with-profits fund**
- finance the strains of writing new business within the **with-profits fund**
- bear any other costs, which are considered to be attributable to **with-profits policyholders**, and where charging of the **inherited estate** is considered to be an equitable way of passing these costs to with-profits policyholders.

10.2 An allowance can be made in the calculation of the amount used to guide **payouts** to **with-profits policyholders** to finance the expected cost of the benefits provided to **with-profits policyholders** by the **inherited estate**.

10.3 The **Board** sets a broad target level for the **inherited estate** that it regards as being appropriate, taking into account the costs and liabilities expected to be borne by the **inherited estate**, ELL's business plans and the benefit to **with-profits policyholders** of maintaining an **inherited estate**.

10.4 In the event of the **inherited estate** deviating substantially from its broad target level, the amounts used to guide payouts can be charged or credited in order to attempt to restore the **inherited estate** to its target level over time.

10.5 ELL only has one **with-profits fund**. There is therefore no division of the **inherited estate** between **with-profits funds**. No group or groups of **with-profits policyholders** have an entitlement to the **inherited estate**.

10.6 There are no constraints on ELL's freedom to deal with the **inherited estate** within the context of the **with-profits fund** as a result of previous dealings.

Practices

10.7 The **inherited estate** is used to meet the costs as outlined in the Principles above.

10.8 ELL's investment strategy for the **inherited estate** is currently the same as the rest of the **with-profits fund** but may vary from time to time according to a combination of the Board's expectations of investment conditions and the relative size of the **inherited estate**.

10.9 The Board currently aims for the **inherited estate**, less an adjustment in respect of the **expected cost of guarantees**, to be up to 15% of the total asset value of the **with-profits fund**.

11. Other items

Volume of new business and arrangements on stopping taking new business within the with-profits fund

Principles

11.1 The volume and type of new business acceptable to be sold within the **with-profits fund** takes into account the following;

- the level of **guaranteed benefits** granted to **with-profits policyholders**
- the level of capital required by the **Regulator** in respect of the new business, and the period over which that capital is expected to be recovered
- the **with-profits fund's** risk appetite
- capital available to finance new business

11.2 ELL sells new business in the **with-profits fund** only if, in the reasonable opinion of the **Board**, doing so is unlikely to have a material adverse effect on the interest of existing **with-profits policyholders**.

11.3 In the event of permanent closure of the **with-profits fund** to new business, the **Board** would take steps to ensure an equitable allocation of the **with-profits fund's** assets. This may include partial or full distribution of any **inherited estate**.

11.4 If at any time the number of **with-profits policies** allocated to the **with-profits fund**, together with **with-profits policies** not allocated to the **with-profits fund** where the investment element of the policy is reassured to the **with-profits fund**, is less than 1000, ELL may cease to maintain the **with-profits fund** as a separate sub-fund in accordance with the Scheme.

The assets and liabilities of the **with-profits fund** shall then be transferred to the other sub-fund or sub-funds and future bonuses in relation to **with-profits policies** allocated to the **with-profits fund** will be guaranteed at levels determined by the **Actuary**.

Practices

11.5 ELL sets maximum volumes of new business according to the current level and expected future level of **solvency**.

11.6 ELL considers new business into the with-profits fund with an annual premium equivalent of £50,000 sufficient to justify the with-profits fund staying open to new business.

11.7 The number of policies in the with-profits fund is currently in excess of 10,000 policies.

Equity between the with-profits fund and any shareholders

Principles

11.8 All **surplus** arising in the **with-profits fund** is attributable to **with-profits policyholders** or the **inherited estate**.

11.9 Any changes to the profit sharing arrangements will be subject to an investigation by an independent expert, which will include a recommendation as to the appropriate level of compensation costs, and subsequent Court process.

A Glossary

Accumulated guarantees

Sum assured plus previously declared **regular bonus**.

Actuary

The person who from time to time is the actuary appointed by ELL to perform the role of With Profits actuary (WPA). The WPA's main duties include advising the board on key aspects of its exercise of discretion in relation to the **with-profits policyholders**.

Amount payable

See the definition of **payouts**.

Annual premium equivalent

This is the result of converting new single premium and new annual premium sales into one equivalent figure. The calculation adds to the new annual premium one tenth of the new single premium sold in a particular period.

Asset share

In relation to a policy, the accumulated value of premiums paid with deductions for expenses, mortality charges, charges for the use of capital, **miscellaneous profits or losses** and tax, where the accumulation rate is the rate of return achieved by the assets assumed to back the asset shares in question.

Board

The Board of directors from time to time of ELL

Bonus recommendation

The process whereby the **Actuary** recommends **regular** and **final bonus** rates for approval by the **Board**.

Bonus series

A group of policies considered separately in the **bonus recommendation**.

Capital adequacy

The excess of ELL's capital resources over its capital resources requirement as defined by the rules of the **Regulator**.

Cost of guarantees

The amounts by which **payouts** of **guaranteed benefits** exceed the **asset shares**.

Cost of smoothing

The extent to which the **payout** under a **with-profits policy** diverges from its asset share except where due to applicable **guaranteed benefits**.

Counterparty

An individual or company in which ELL has made investments or against which it has rights under a contract.

Conventional policy

Any **with-profits policy** that is not a **Deposit Administration** policy or a With Profit Bond policy.

Deposit Administration

Deposit Administration policies may also be known as Pension Accumulation Fund policies.

Derivative instruments

Include options, futures contracts and contracts for differences and includes contracts under which the amount payable by either **counterparty** is calculated by reference to the value of any other asset.

Effective Date

Date on which the **Scheme** became effective (31 July 2003).

Equity backing ratio

The proportion of total assets by market value in the **with-profits fund** invested in equity and property type assets.

Expected cost of guarantees

An assessment of the current value of the projected *future cost of guarantees*.

Exposure

The amount of assets that are at risk through the failure of an individual **counterparty** or collection of counterparties.

Final bonus

A method of distributing **surplus**, whereby the bonus is only declared when **payouts** are made.

FSA

The Financial Services Authority is an independent body, which regulates the financial services industry in the UK.

Former ALA policies

Policies sold in Allchurches Life Assurance Limited (now Ecclesiastical Life Limited) prior to the **Effective Date** of the Scheme

Former ALA with-profits policies

With-profits policies sold in Allchurches Life Assurance Limited (now Ecclesiastical Life Limited) prior to the Effective Date of the **Scheme**.

Former EIO policies

Policies sold in Ecclesiastical Insurance Office plc prior to the **Effective Date** of the **Scheme**

Guaranteed benefits

The amount specified under the policy as being payable on a particular event such as on death or on survival to the end of the term of the policy.

Inherited estate

The value of assets maintained within the **with-profits fund** reduced by the value of **other liabilities**, less the aggregate of the amounts used to guide payouts.

Interim bonus

The bonus declared in respect of the period since the last declaration of **regular bonus** to the date of claim.

Long Term Fund

The long term fund of ELL comprising life assurance, pensions and other similar business within the definition of "long term insurance business" in the Glossary in the FSA Handbook.

Market value adjustments

A downward adjustment made to surrender values in order to meet the aims described in paragraph 3.8.

Miscellaneous profits or losses

Profits or losses other than arising from investment returns, **mortality cost**, tax and expenses.

Mortality cost

Excess of benefits paid on death over **asset shares**.

Other liabilities

Statutory liabilities held in excess of basic policyholder liabilities, such as current liabilities and any provision for capital gains tax.

Payouts

The amounts payable at maturity, retirement, death or earlier surrender to policyholders. The payout on death is the total amount payable if the policyholder dies while the policy is still in force. The payout on maturity is the total amount payable at the date originally agreed as being the maturity date of the policy if it is still in force at that time. The payout on surrender is the total amount payable if the policyholder decides to cash in (or transfer in respect of a pension) the benefits at a date other than the originally agreed termination date.

Policyholder assets

The value of assets maintained within the **with-profits fund** less the amount of any **inherited estate**.

Regular bonus

A method of distributing **surplus**. The bonus is declared each year but is only paid at the time that **payouts** are made.

Regulator

The **FSA** or such other body as shall from time to time carry out such functions in relation to insurance business carried on in the United Kingdom as are allocated to the **FSA** under the Financial Services and Markets Act 2000 at the date of this document.

Scheme

The scheme sanctioned by the High Court of Justice in England by Order on 28 July 2003 pursuant to section 111 of the Financial Services and Markets Act 2000, under which the long term insurance business of Ecclesiastical Insurance Office plc was transferred to Allchurches Life Assurance Limited (renamed Ecclesiastical Life Limited).

Solvency

The level of **surplus** in the **with-profits fund**.

Statutory liabilities

The liabilities determined in accordance with the rules of the **Regulator**.

Sum assured

The amount specified under the policy as being payable, before any **regular bonus** or **final bonus** is added, on survival to the end of the term of the policy or death if applicable.

Surplus

In relation to the **with-profits fund** the excess of the value of the funds assets over the amount of its **statutory liabilities**.

With-profits fund

A sub-fund of the ELL **Long Term Fund** where policyholders are entitled to a share of the profits of the sub-fund.

With-profits policy

Any policy which at the relevant time confers on the holder a right to share in the profits of the **with-profits fund**.

With-profits policyholder

A person who holds a **with-profits policy**.

Without profit fund

The sub-fund of the ELL **Long Term Fund** containing **without profit policies**.

Without profit policies

Policies that are not **with-profits policies**.

B Summary of the expense agreement

Section 9 above covers the charges and expenses applied to the **with-profits fund**. The following is a summary, included for ease of reference only, of the expense agreement between the **with-profits fund** and the **without profit fund** as detailed in paragraph 19 and Schedule 2 of the **Scheme**. For the full wording a copy of the **Scheme** can be obtained from ELL.

Summary of paragraph 19 and Schedule 2 of the Scheme

1. Amounts of expenses are debited to the **with-profits fund** and credited to the **without profit fund** in respect of acquisition, maintenance and investment expenses.

2. The expenses paid by the **with-profits fund** are based on the numbers of policies in the with-profits fund, the levels of new business in the **with-profits fund** and the value of the total assets of the **with-profits fund**.

2.1. The expense based on the number of policies in the **with-profits fund** is a fixed amount detailed in a table in schedule 2 of the **Scheme** increased each year by a percentage related to the increase in retail prices. The amounts vary according to differences in policy types.

2.2. The expense based on the level of new business is dependant on the numbers of policies sold and the level of premium corresponding to the new policies.

2.3. The expense based on the total assets of the **with-profits fund** is calculated as 0.25% per annum of the total asset value of the **with-profits fund**.

3. The **Scheme** allows the expenses to be changed under exceptional circumstances but only after independent verification that the changes are fair.

4. The expenses charged to the **with-profits fund** in respect of **Deposit Administration** business includes both the actual charges made by the third party administrator and the charges referred to in 2.3 above.

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