

# Principles and Practices of Financial Management for the Heritage With-Profits Fund

December 2023

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## Preface

Phoenix Life Limited (“Phoenix”) is a life assurance company based in the United Kingdom (“UK”). Phoenix is a wholly owned subsidiary of Phoenix Group Holdings (the “Holding Company”).

Details about the Phoenix Group are available on the website, [thephoenixgroup.com](http://thephoenixgroup.com)

On 10 July 2006 The Standard Life Assurance Company demutualised and transferred substantially all of its existing business into the Heritage With-Profits Fund of Standard Life Assurance Limited (“SLAL”).

The Phoenix Group acquired SLAL in August 2018. On 27 October 2023 the business of SLAL was transferred into Phoenix. A newly established Heritage With-Profits Fund was set up in Phoenix and all the business in the SLAL Heritage With-Profits Fund (“SLAL HWPF”) was transferred into the new Phoenix version of the Fund.

On 29 March 2019 the Irish, German and Austrian business in the SLAL HWPF was transferred to Standard Life International Designated Activity Company (“SL International”) and simultaneously reinsured back to the SLAL HWPF. SL International is a wholly owned subsidiary of Phoenix Group Holdings. Following the transfer of the SLAL business into Phoenix this non-UK with-profits business is reinsured to the Heritage With-Profits Fund of Phoenix. The terms of the reinsurance arrangement ensure that this non-UK with-profits business continues to participate in the Heritage With-Profits Fund.

Phoenix’s aim when managing our with-profits business in the Heritage With-Profits Fund is to optimise investment returns and provide growth over the long term for with-profits policies, while continuing to maintain an appropriate level of financial strength so we can meet all contractual obligations to our with-profits policyholders. In seeking to achieve this objective, we make decisions that we believe are in the interests of our with-profits policyholders, having regard to their reasonable expectations and to the requirement to treat policyholders fairly. Where necessary we will also balance the interests of with-profits policyholders and shareholders, but subject always to treating all our policyholders fairly.

This document gives information on how we make the decisions that affect our with-profits business in the Heritage With-Profits Fund (“the Fund”). Unless specifically stated otherwise, where we talk about “policyholders” in this document we mean both UK policyholders who participate directly in the Fund and non-UK policyholders who participate in the Fund by reinsurance.

Phoenix is required to operate the Heritage With-Profits Fund in a manner consistent with the terms of the Scheme pursuant to Part VII of, and Schedule 12 to, the Financial Services and Markets Act 2000 that gave effect to the transfer of the SLAL business into Phoenix (the “Scheme”). The key provisions of the Scheme applicable to the Heritage With-Profits Fund are summarised in Appendix D. If there are any conflicts between this document and the Scheme, the Scheme shall prevail.

The Principles and Practices of Financial Management set out in this document describe the way in which Phoenix currently seeks to manage its with-profits business in the Heritage With-Profits Fund. 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 Phoenix 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 Phoenix 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 Phoenix. Equally, Phoenix 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 Phoenix wishes policyholders to have as clear an understanding as practicable of how Phoenix will seek to manage the with-profits business, it is not in policyholders' interests for Phoenix to do so by reference to rigid and inflexible criteria. Phoenix therefore seeks to respond to events in managing the with-profits business, and may adapt accordingly the Principles and Practices by reference to which it seeks to carry on that business. These Principles and Practices are likely to evolve significantly over time, in response to changing experience within the Heritage With-Profits Fund, and changing events outside it, such as changes in investment markets and insurance company legislation and regulation.*

*For these reasons, the statements made in this document represent the criteria to which Phoenix currently has regard, and the objectives it is currently seeking to pursue, in making judgements about the management of its with-profits business.*

*This document is not intended to alter the rights and obligations under any policy documents. 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.*

*We hope that this document will be helpful in explaining the Practices we adopt, as well as the Principles we seek to apply, in the management and operation of our with-profits business.*

## Background to the Principles and Practices of Financial Management

*The Scheme requires Phoenix to maintain the Principles and Practices of Financial Management (“PPFM”) for the Heritage With-Profits Fund.*

*All UK with-profits providers are required by the Financial Conduct Authority (“FCA”) to document and make available the PPFM that describes how they operate their UK with-profits business. The FCA prescribes the areas that this document (“this PPFM”) should cover and requires that it be set out in terms of Principles (enduring statements of the overarching standards that apply) and Practices (more detailed statements on the current approach.)*

*Additionally, the reinsurance arrangement that reinsures the Irish, German, and Austrian with-profits business into Phoenix’s Heritage With-Profits Fund also requires Phoenix to maintain and comply with this PPFM (as amended from time to time).*

*The Principles set out in this PPFM are the same for UK and non-UK business and many of the Practices are similar. Where Practices differ, this document sets out those applicable to UK with-profits policyholders and highlights important differences for non-UK policyholders.*

*The Principles are set out in full in Section 2. In addition, in subsequent sections the Principles are presented in bold font and set within boxes alongside the Practices to which they relate. Where appropriate, the Practices distinguish between different types of with-profits business. In order to assist the reader to select the material most relevant to their particular interests, Appendix A (UK), Appendix B (Ireland) and Appendix C (Germany and Austria) of this document list the various products that allow investment in with-profits and give their type.*

*This PPFM not only provides policyholders with an explanation of how with-profits business is operated, but also forms an important part of the governance arrangements of our with-profits business.*

# 1. Introduction to Standard Life With-Profits

The Standard Life with-profits business covered by *this PPFM* are those *with-profits policies* that were transferred or reinsured into the *Heritage With-Profits Fund* of Phoenix on 27 October 2023 and any subsequent additional business written in *the Fund*. This business continues to use the Standard Life brand.

This Section provides background on:

- the different types of Standard Life *with-profits policies* and an overview of the approach to determining *payouts*;
- the structure of *Phoenix* and its Long-term Business Fund;
- the nature of the business in the *Heritage With-Profits Fund*;
- the scope of application of *this PPFM*; and
- the governance of the *Heritage With-Profits Fund*.

The content of this Section, the earlier Preface and Background Sections, and all of the Appendices do not have the status of either Principles or Practices of Financial Management. Rather they are intended to provide context and to assist the reader to understand the Principles and Practices that follow in later sections.

A Glossary defining key words and phrases used in *this PPFM* is set out at the end of this document. Any words or phrases in italics from this section onwards are defined in the Glossary.

## Types of with-profits policy

*With-profits policies* come in a number of different types. Product details of the various types that allow investment in with-profits covered by *this PPFM* can be found in Appendix A (UK), Appendix B (Ireland) and Appendix C (Germany and Austria) of this document.

- **Conventional With-Profits.** This is the oldest form of *with-profits policy*. In general, a *guaranteed benefit* is set at the time the policy is issued. This is the minimum benefit guaranteed to be paid on date(s) or events specified under the policy. Regular bonuses may be added to the *guaranteed benefit* over the term of the policy. In addition, a final bonus may be paid.
- **Unitised With-Profits.** This type of *with-profits policy* was first introduced into our product range in the 1980s. Contractual benefits are determined by reference to the number of units allocated under the relevant Unitised *with-profits policy*. The number of units allocated increases on payment of premiums (with the number of units allocated depending on the unit offer price applicable at the time of allocation and, in some cases, on certain contractual charges). There are three sub-types, I, II and III, as set out below.
  - **Unitised Sub-type I.** For Unitised Sub-type I policies unit prices in any *sub-fund* (excluding the Pension Inflation Plus Fund, see Section 3.2.2.2) grow in line with the sum of:
    - the applicable guaranteed minimum growth rate contractually agreed in relation to the units of that *sub-fund* (either 0%, 3% or 4% a year); and
    - any (additional) bonus growth rate in relation to units of that *sub-fund* for that *class of policy* (subject to a minimum of 0% a year).

The *unit value* of a policy (by which we mean the number of units allocated at the time multiplied by the appropriate unit bid price) is guaranteed as a minimum *payout* in certain circumstances, as described in the relevant contractual terms and conditions.

In addition a final bonus may be payable when benefits are taken. Under Unitised Sub-type I policies, any final bonus is calculated using rates derived from an investigation of relevant *representative* policies.

- **Unitised Sub-type II.** As for Unitised Sub-type I policies, guaranteed minimum unit price growth rates (currently 0% a year for all such policies) apply, and regular bonus growth rates and final bonuses may apply but, unlike Unitised Sub-type I policies, any final bonus is based on individually calculated *asset shares* (after any *smoothing* and any other discretionary adjustments are applied). Again the *unit value* acts as a guaranteed minimum *payout* in certain circumstances, as stated in the relevant contractual terms and conditions.
- **Unitised Sub-type III.** This is the most recently introduced form of *with-profits policy*. Unitised Sub-type III policies do not have regular or final bonuses. *Unit values* are determined directly from individually calculated *asset shares*, which can fall as well as rise. *Payout* values are determined directly from individually calculated *asset shares* (after any *smoothing* and any other discretionary adjustments are applied). Unitised Sub-type III policies do not have a guaranteed minimum *payout*.
- **With Profits Pension Annuity.** This product works differently from other forms of annuity and also from other types of *with-profits policies* (see Sections 3.3.2.6 and 3.5). The level of annuity income varies over the lifetime of the policy depending on the smoothed annual performance of the relevant with-profits assets after making appropriate deductions (for example for charges). While it does not carry a guarantee of investment performance, there is a limit on how much the annuity income under a policy can reduce in any one year.
- **Trustee Investment Plans.** These policies are investment-only contracts, available to occupational pension schemes. In some ways they operate in a similar manner to Unitised Sub-type I policies, but there are differences (see Section 3.6).

Different regular bonus rates may apply depending on the *class of policy* and different final bonus rates may apply (where applicable) depending, for example, on the *class of policy* and the type of claim.

The different types of claim for *with-profits policies* include:

- deaths;
- *maturities*;
- regular income payments under the With Profits Pension Annuity ;
- *regular withdrawals* under the With Profits Bond; and
- other *withdrawals*.

In all cases we seek to treat policyholders fairly. Our current practice for most *with-profits policies* is to use *asset shares* (together with certain discretionary adjustments including *smoothing*) as a tool to set fair *payouts* for with-profits policyholders. For some *with-profits policy* types our current method for determining *payouts* involves looking at the *asset shares* of individual policies, whereas for other policy types we investigate the *asset shares* of relevant *representative* policies. Details of these practices and methods can be found in Sections 3.3 and 3.4.

For minor classes of *with-profits policies*, where it is considered appropriate and cost effective, *Phoenix* may, at the *Board's* discretion, use *asset shares* for similar types of *with-profits policies* or some equivalent measure as a proxy to their *asset shares*.



Our policy for fair treatment of with-profits policyholders includes *smoothing* in accordance with the Principles and Practices set out in *this PPFM*. *Smoothing* can help to reduce the effects on payout values of fluctuations in *investment returns* that arise shortly before a claim is paid. While we cannot fully protect with-profits policyholders from fluctuations in *investment returns*, we aim to smooth the effects of these over time for maturing policies and may also do so on *withdrawal* (see Section 3.3.2.7).

## Phoenix's Long-term Business Fund

*Phoenix's* assets are divided between a large long-term business fund and a smaller Shareholder Fund. The long-term business fund is internally segregated into a *Non-Profit Fund* and 17 with-profits funds.

The with-profits fund covered by *this PPFM* is the *Heritage With-Profits Fund*. The other with-profits funds maintained by *Phoenix* are:

- the 90% With-Profits Fund;
- the 100% With-Profits Fund;
- the Alba With-Profits Fund;
- the Britannic Industrial Branch Fund;
- the Britannic With-Profits Fund;
- the German Smoothed Managed With-Profits Fund;
- the German With-Profits Fund;
- the LL With-Profits Fund;
- the NPL With-Profits Fund;
- the Pearl With-Profits Fund;
- the Phoenix With-Profits Fund;
- the SAL With-Profits Fund;
- the Scottish Mutual With-Profits Fund;
- the SERP Fund;
- the SPI With-Profits Fund; and
- the UK Smoothed Managed With-Profits Fund.

The *Heritage With-Profits Fund* is the fund into which all the *SLAL HWPF* UK business (both with-profits and non with-profits) was transferred on 27 October 2023. It contains policy increments written after that date and allocated to the *Heritage With-Profits Fund*. Other additional business may be allocated to *the Fund* subject to limitations set out in the *Scheme*, see Section 5.3.

The Irish, German and Austrian business in the *SLAL HWPF* was transferred from *SLAL* to *SL International* on 29 March 2019 and is now reinsured to the *Heritage With-Profits Fund*. It continues to participate in *the Fund* via reinsurance.

Unless stated otherwise, any references in *this PPFM* to *Phoenix* are in relation to its management of the *Heritage With-Profits Fund* only. *Phoenix* may use different approaches to managing its other with-profits funds. There are separate PPFM documents covering the other UK funds that are available online:

[thephoenixgroup.com/customer-support/with-profits](https://thephoenixgroup.com/customer-support/with-profits)

## SL International Reinsurance

The reinsurance agreement by which the *SL International* policyholders participate in the *Heritage With-Profits Fund* is on a basis whereby *Phoenix* shall follow all the decisions, fortunes and settlements of *SL International*, subject to three limitations:

- (i) *SL International* is responsible for operational risk it incurs;
- (ii) *Phoenix* is only liable for amounts that would have been paid on the policy had it been directly participating; and
- (iii) *Phoenix* is not liable for amounts that have been determined in a manner inconsistent with the established practices of *Phoenix*.

*Phoenix* has the right to review and approve communications material from *SL International* to its with-profits policyholders that relate to the reinsured non-UK policyholders where the subject matter could materially extend *Phoenix's* obligations to those policyholders.

The terms of the reinsurance arrangement between *Phoenix* and *SL International* require both parties to co-run the Reinsurance Business Committee comprising 3 representatives from each party. This committee will oversee and monitor the operation of the reinsurance.

In addition, *SL International* have issued a Deed Poll for the benefit of its policyholders giving a commitment that it will pay no less than the amount *Phoenix* pays to *SL International* for that policy under the reinsurance arrangement.

## Overview of Standard Life's Heritage With-Profits Fund

The *Heritage With-Profits Fund* contains both with-profits and *non with-profits business*. It contains UK business that is written directly and non-UK business reinsured from *SL International to the Fund*.

The *Heritage With-Profits Fund's* assets that back *non with-profits business* (for example, investment-linked funds, term assurances and non with-profits annuities) are generally invested in accordance with separate investment strategies and policies. For example, the assets backing the relevant investment-linked funds are invested in line with the specified investment objectives of those funds and in accordance with the regulatory rules.

The assets in the *Heritage With-Profits Fund*, other than those backing *non with-profits business*, comprise the following:

- assets backing the *asset shares* of *with-profits policies*;
- assets backing provisions made for other liabilities of the *Heritage With-Profits Fund* (including a provision for the possibility that the *guaranteed benefits* for some *with-profits policies* may exceed their *asset share*, but disregarding any liability to distribute the *Inherited Estate*); and
- assets constituting the *Inherited Estate*.

In order to protect non-UK policyholders (who now participate in *the Fund* via reinsurance) *SL International* has a fixed charge over all the assets that can be placed under such a charge and that back the non-UK asset shares or the non-UK non with-profits business. There are some circumstances in which *Phoenix* would be required to place additional assets under the fixed charge but such additional assets will not come from the *Heritage With-Profits Fund*. In the unlikely event of *Phoenix* becoming insolvent or otherwise defaulting on its payment obligations, *SL International* would have a right to enforce the charge and thereby receive these assets.

*Phoenix* has also granted *SL International* a floating charge over a wider pool of assets (not limited to *Heritage With-Profits Fund* assets) to protect the entitlement of the non-UK policyholders. This floating charge includes a provision to protect *Phoenix's* UK policyholders by limiting *SL International's* entitlement in the event of *Phoenix's* insolvency to broadly the amount that would be payable if the *SL International* policyholders were direct policyholders of *Phoenix*.

There is no such provision in the fixed charge. Therefore, in the highly unlikely circumstance that the theoretical total payout to *SL International* was lower than the amount paid under the fixed charge, *SL International* policyholders will receive more than they would have done as direct policyholders. Any such excess payout would reduce payouts to all of *Phoenix's* direct policyholders (not only those within the *Heritage With-Profits Fund*).

All of the assets in the *Heritage With-Profits Fund* in excess of those backing *non with-profits business* are available to support the with-profits business. These assets, together with the further capital defined in the *Scheme*<sup>1</sup>, are taken into account when deciding the investment strategy to follow and other discretionary actions. However, certain cashflows defined in the *Scheme*<sup>1</sup> ("*shareholder cashflows*") are transferred out of *the Fund*, provided that they are not required by the terms of the *Scheme* to remain in the *Heritage With-Profits Fund* to meet its liabilities. Profits and losses, other than *shareholder cashflows*, fall to the *Inherited Estate*.

The primary role of the *Inherited Estate* is to provide for the possibility that the provisions made for the liabilities of the *Heritage With-Profits Fund* may prove to be insufficient and for any unforeseen liabilities attributable to the *Heritage With-Profits Fund*. Liabilities that may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme* include, but are not limited to, historic liabilities relating to business risks undertaken by The Standard Life Assurance Company prior to its demutualisation and other losses that may arise from the business risks attributable to *the Fund*.

To the extent that the *Board* is satisfied that the *Inherited Estate* exceeds the amount required to meet its primary role, any excess *Inherited Estate* shall be distributed over time as described in Section 5.2.

## Scope of application of this PPFM

*This PPFM* applies to the with-profits business in the *Heritage With-Profits Fund* only. In *this PPFM* all references to the Fund should be taken to mean the *Heritage With-Profits Fund*.

This document does not (in any way) amend, vary or alter (expressly or implicitly) the contractual terms and conditions of any *with-profits policies*, as varied (if applicable) by the terms of the *Scheme*. If there is any conflict between any Principle and/or Practice set out in *this PPFM* and any contractual term or condition of a *with-profits policy*, then the relevant contractual terms and/or conditions shall prevail.

*This PPFM* meets the following requirements:

- the *Scheme* requirement to maintain a PPFM for *the Fund*;
- the terms of the reinsurance arrangement between *Phoenix* and *SL International* that *Phoenix* shall maintain and comply with *this PPFM*; and
- UK regulations that require *this PPFM* to be maintained for UK policyholders.

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<sup>1</sup> Details of which are summarised in Appendix D of this document.

The *Heritage With-Profits Fund* contains with-profits business originating from a number of countries – the UK, Ireland, Germany and Austria and the same *Principles* apply to all with-profits business in *the Fund*. Many of the *Practices* are the same and where they differ this document sets out the *Practices* for the UK with-profits policyholders and highlights important differences for non-UK policyholders.

## Governance of the Heritage With-Profits Fund

This section describes the governance arrangements for the *Heritage With-Profits Fund*, and sets out the process by which decisions on the exercise of discretion within *the Fund* are taken.

*Phoenix* is advised on the exercise of discretion in the *Heritage With-Profits Fund* and on the reasonable expectations and fair treatment of with-profits policyholders by the *With-Profits Actuary*. In doing so the *With-Profits Actuary* considers all with-profits policyholders in the Fund - *Phoenix* policyholders whose policies originated in the UK and *SL International* policyholders whose policies originated in Ireland, Germany or Austria and which participate in the *Heritage With-Profits Fund* by reinsurance.

*Phoenix* has also established a With-Profits Committee. The constitution and terms of reference of the With-Profits Committee are available on the website, [standardlife.co.uk/withprofits](http://standardlife.co.uk/withprofits)

The terms of reference of the With-Profits Committee require it to provide an independent assessment of compliance with the Principles and Practices set out in this document (including in respect of the actions taken to balance the rights and interests of policyholders and shareholders). The With-Profits Committee does not itself make decisions with regard to the management of the business of the *Heritage With-Profits Fund*.

Its duties include to report on and provide clear advice to the *Board* (or the relevant committee or person to whom the decision making authority has been delegated) as to the fairness to with-profits policyholders, and as amongst groups of with-profits policyholders. It reports on any issues with which the *Board* or the With-Profits Committee considers with-profits policyholders might expect the With-Profits Committee to be involved including;

- the way in which the *Heritage With-Profits Fund* is managed and whether this is properly reflected in *this PPFM*; or
- whether the *Board* has addressed effectively the conflicting rights and interests of with-profits policyholders and other policyholders or stakeholders including, if applicable, shareholders in a way that is consistent with appropriate conduct and the principle of treating customers fairly.

As with the *With-Profits Actuary*, the With-Profits Committee's responsibilities extend to all with-profits policyholders in the Fund.

Senior managers in *Phoenix* will document any discretionary actions proposed to be taken in relation to the *Heritage With-Profits Fund*. All material discretionary actions proposed will be discussed with the *With-Profits Actuary* and the With-Profits Committee. Specifically, the With-Profits Committee will review all material recommendations as to how the *Board* might exercise its discretion. The Board of *Phoenix* will decide on the actions to be taken, after taking into account the views expressed by the With-Profits Committee, the *With-Profits Actuary* and, in respect of non-UK policyholders, *SL International*. The *Board* delegates some of this decision-making power to other appropriate committees or persons.

The With-Profits Committee may append a report of its own on the exercise of discretion in the *Heritage With-Profits Fund* to *Phoenix's* annual report to UK with-profits policyholders on this topic if it wishes. If the With-Profits Committee's report is relevant to non-UK with-profits policyholders then it will also be presented to *SL International*.

The Board of *Phoenix* will ensure that the With-Profits Committee has access to all information and support the With-Profits Committee requires to perform its role in accordance with its terms of reference. The With-Profits Committee may also engage professional advice to support its work.

The Board of *Phoenix* will bring all relevant matters to the attention of the With-Profits Committee in good time.

## 2. Principles of Financial Management

For consistency, the numbering used below is the same as that used in the later sections from which the *Principles* have been reproduced.

### General Principles

**3.1.1.1** All references in this *PPFM* to the “financial position of the *Heritage With-Profits Fund*” shall mean the financial position of a Notional Company, in accordance with the terms of the *Scheme*<sup>2</sup>, determined at that point in time.

For the avoidance of doubt, any projection of the financial position of the *Heritage With-Profits Fund* to a future date will reflect events that are expected, in the projection scenario in accordance with this *PPFM*, to have happened before that future date. That is, we take account of the transfer of any *shareholder cashflows* out of the Fund and any distribution of any *Inherited Estate* that are expected to have happened before the relevant future date.

**3.1.1.2** *Phoenix* aims to treat its with-profits policyholders fairly. *Phoenix* will operate with-profits business in the *Heritage With-Profits Fund* in accordance with the *Principles* and *Practices* set out in this document and in accordance with the terms of the *Scheme*.

**3.1.1.3** Any changes to the *Principles* must be approved in advance by the Board and will be notified to UK with-profits policyholders normally at least three months in advance of them becoming effective.

**3.1.1.4** Any changes to the *Practices* must be approved by appropriate senior managers or committees within the authorities delegated by the *Board*, and will be submitted to the *Board* for review in due course as part of the regular monitoring of the with-profits business. UK with-profits policyholders will be notified of changes to the *Practices*. Such notification may be given in arrear but will be within a reasonable time period of the effective date of the change.

**3.1.1.5** In managing the with-profits business in accordance with this *PPFM*, the *Board* may delegate to appropriate committees or persons such of its authorities as the *Board* may determine from time to time, including the exercise of any discretion vested in the *Board*. Any such delegation will be appropriately documented.

**3.1.1.6** *Phoenix* may enter into material transactions relating to the *Heritage With-Profits Fund* provided that, in the reasonable opinion of the *Board*, the transaction is unlikely to have a material adverse effect on the interests of the *Heritage With-Profits Fund's* existing with-profits policyholders.

**3.1.1.7** *Phoenix* may make a loan to a *connected person*, or give a guarantee to, or for the benefit of a *connected person*, using assets in the *Heritage With-Profits Fund* provided that it is on commercial terms, and, in the reasonable opinion of the *Board*, will be beneficial to the with-profits policyholders in the *Heritage With-Profits Fund*, and will not expose them to undue credit or group risk.

### Setting Regular Bonuses

**3.2.1.1** Regular bonuses are declared at the discretion of the *Board*. Regular bonuses are set at levels which aim to achieve a gradual build-up in guaranteed *with-profits policy* benefits whilst not unduly constraining the investment freedom and the prospects for final bonuses. In setting regular bonus rates, the *Board* also takes into account the current and projected financial position of the *Heritage With-Profits Fund* and, were it necessary, would set regular bonus rates to zero.

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<sup>2</sup> Details of which are summarised in Appendix D of this document.

3.2.1.2 Regular bonus rates are set for each relevant *class of with-profits policy* and/or *sub-fund* and reflect its characteristics, including any guarantees. *Phoenix* will declare separate regular bonus rates where we believe significant differences between *with-profits policy classes* and/or generations of a *with-profits policy class* and/or *sub-funds* make this appropriate in the interests of fairness, both to the with-profits policyholders affected and to the with-profits policyholders as a whole.

## Setting Payouts - Overview

3.3.1.1 *Phoenix's* aim is that, subject to meeting all contractual obligations and maintaining an adequate financial position for the *Heritage With-Profits Fund*, *payouts* on a *with-profits policy* (including any final bonus applying) should fairly reflect the experience of the *Heritage With-Profits Fund* applicable to such a policy, after any adjustments for *smoothing*, and any distribution of the *Inherited Estate* deemed appropriate by the *Board*.

3.3.1.2 In order to determine *payout* levels (including amounts and rates of final bonus and/or Unit Price Adjustments) *Phoenix* uses a variety of methods reflecting the different *classes of with-profits policy* and/or types of unit *sub-fund*.

3.3.1.3 When setting *payout* levels, *Phoenix* seeks to ensure fair treatment between those with-profits policyholders who choose to withdraw and those who remain.

3.3.1.4 Other than for minor *classes of with-profits policies* (constituting less than 10% of total with-profits liabilities) where alternative methods may be used, see Section 3.4.1.2, in order to ensure equity between different groups of *with-profits policies*, *Phoenix* determines *payouts* (including final bonus rates and/or Unit Price Adjustments) by reference to *asset shares*.

3.3.1.5 In calculating with-profits *asset shares*, *Phoenix* will make fair deductions where appropriate to reflect its assessment of the cost of guarantees.

3.3.1.6 For with-profits policies where asset shares are determined on an expense basis, there will be a 0.5% per annum deduction as a contribution to the capital of the *Heritage With-Profits Fund*.

3.3.1.7 Other than those described in *this PPFM*, no deductions will be made from the *asset shares* of *with-profits policies* unless and to the extent that the *Inherited Estate* has been exhausted and the expected value of future *shareholder cashflows* has been applied to meet liabilities of the *Heritage With-Profits Fund* (other than the liability to make a transfer to shareholders).

3.3.1.8 In normal circumstances, *Phoenix* seeks to smooth *payouts* to with-profits policyholders at the time of claims due to *maturity*.

3.3.1.9 *Phoenix* may, at its discretion, also provide some *smoothing of payouts* for death claims, and some or all types of *withdrawal*, at the time of payment.

3.3.1.10 *Phoenix* aims to operate *smoothing of payouts* in such a way as to be neutral for with-profits policyholders as a whole over time, but the *payout* applicable for any individual policyholder may be impacted positively or negatively by the application of *smoothing*. *Smoothing* formulae will be set from time to time to take into account current and expected economic conditions.

3.3.1.11 The *Board* regularly monitors the expected and actual *smoothing* profits and losses. These profits and losses will normally be reflected in *payouts* of the remaining with-profits policyholders.

3.3.1.12 The methodology and parameters used in *payout* calculations may, of necessity, involve some measure of approximation. *Phoenix* reviews regularly the methodology and parameters used and sets parameters on bases appropriate for the with-profits *class* and/or unit *sub-fund* concerned.

3.3.1.13 *Phoenix* may change historical parameters applied in *asset share* calculations in the light of subsequent information about actual experience, subject to the requirement to treat policyholders fairly.

3.3.1.14 Variations between the historical parameters and the actual experience of *with-profits policies* may be directly attributed to, or met by, the *asset shares* of *with-profits policies* through *experience adjustments*.

## Allocating Expenses and Charges

3.7.1.1 *Phoenix* will make deductions from *asset shares* for expenses and charges. *Phoenix* aims to apply to each *class of with-profits policies*, over time and so far as is practical, no more than the appropriate charge or the appropriate share of the expenses incurred by The Standard Life Assurance Company prior to its demutualisation or charged to the *Heritage With-Profits Fund* post demutualisation in accordance with the *Scheme*.

3.7.1.2 In accordance with the *Scheme* the only expenses which may be charged to the *Heritage With-Profits Fund* in respect of *with-profits* business are those which in the reasonable opinion of the *Board* have been incurred or will be incurred in the operation of the *Heritage With-Profits Fund*.

## Deductions for the assessed cost of guarantees

3.8.1.1 *Phoenix* will, in calculating *with-profits asset shares* and determining *Declared Rates of Return*, make fair deductions to reflect its assessment of the cost of guarantees.

## How the With-Profits Assets are Invested

4.1.1.1 Within certain constraints determined and reviewed from time to time by the *Board*, *Phoenix* may invest in assets where the future return is uncertain (i.e. that are subject to market risk and other risks), where it believes this is appropriate in terms of the returns likely to be achieved. *Phoenix* usually invests its *with-profits assets* in a wide range of asset classes, usually including equities, property, bonds and cash deposits. This may be achieved through holding appropriate derivative contracts as well as the underlying assets themselves.

4.1.1.2 The investment policy for the *Heritage With-Profits Fund* shall be determined subject to such constraints as may be necessary to ensure that the financial position of the *Heritage With-Profits Fund* is adequate in the opinion of the *Board*.

4.1.1.3 The investment policy for the *Heritage With-Profits Fund* shall have regard to the nature of the liabilities of the *Heritage With-Profits Fund* including guarantees on *with-profits policies* and, in particular, (i) seek to match the liabilities in respect of non *with-profits* policies allocated to the *Heritage With-Profits Fund* with assets of an appropriate nature and term and (ii) have regard to the reasonable expectations of the holders of *with-profits policies* in the *Heritage With-Profits Fund* and the duty to treat them fairly.

4.1.1.4 The investment policy and practices are reviewed regularly by the *Board* to ensure their continued suitability in terms of liquidity, risk (including *counterparty risk*) and likely return, given the obligations and financial position of the *Heritage With-Profits Fund*.

4.1.1.5 *Phoenix* will not back *asset shares* of policies in the *Heritage With-Profits Fund* with assets that are, because of their importance to the *Phoenix Group*, not normally traded.

4.1.1.6 The *investment return* attributed to the *asset shares* of a particular group of *with-profits policies* will reflect the net investment returns on the mix of the assets notionally backing that group of business.



4.1.1.7 In determining from time to time how the assets of the *Heritage With-Profits Fund* shall be invested, *Phoenix* shall use all reasonable endeavours to ensure that the *Heritage With-Profits Fund* is treated fairly compared with its other funds.

4.1.1.8 Subject to the above *Principles*, we will seek to optimise the *investment return* on assets backing *with-profits policies*.

## Business Risks and Rewards

5.1.1.1 *Phoenix* will undertake business risk on behalf of with-profits policyholders in the *Heritage With-Profits Fund* only if the *Board* consider that such business risk will, over time, provide benefits to the with-profits policyholders in the *Heritage With-Profits Fund* and is within the limitations set out in the *Scheme*.

5.1.1.2 *Phoenix* will undertake business risk in the *Heritage With-Profits Fund* (including, but not limited to, the writing of additional business) only if it is not expected to (i) materially and adversely affect the reasonable expectations of existing with-profits policyholders; (ii) materially and adversely affect the quantum of any *Inherited Estate*; and (iii) impose any material constraint on the manner and timing of any distribution of any *Inherited Estate* to eligible *with-profits policies*.

5.1.1.3 The significant risks associated with particular business activities are carefully considered by the *Board* before being undertaken by the *Heritage With-Profits Fund* and are reviewed regularly thereafter.

5.1.1.4 Any profits or losses resulting from business risks allocated to the *Heritage With-Profits Fund* in accordance with the *Scheme* will fall to the *Inherited Estate*. Any such losses will be met by the *asset shares* of *with-profits policies* only if and to the extent that the *Inherited Estate* has been exhausted and the expected value of future *shareholder cashflows* has been applied to meet liabilities of the *Heritage With-Profits Fund* (other than the liability to transfer these cashflows to shareholders).

## The Role of the Inherited Estate

5.2.1.1 Subject to the constraints elsewhere in this *PPFM*, *Phoenix* will seek to retain an *Inherited Estate* of a size the *Board* considers appropriate to prudently cover amounts that may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*. Any *Inherited Estate* considered by the *Board* to be in excess of the amount needed for this purpose shall be distributed over time as enhancements to *payouts*.

## Management of Additional Business

5.3.1.1 The *Heritage With-Profits Fund* may write additional business if it arises from increments to existing policies in the Fund, an option under an existing policy in the Fund, or in other limited circumstances set out in the *Scheme*, subject in each case to any relevant contractual obligations and the reasonable expectations of with-profits policyholders.

5.3.1.2 The *Heritage With-Profits Fund* may also accept other additional business provided that such additional business is not expected to (i) materially and adversely affect the reasonable expectations of existing with-profits policyholders; (ii) materially and adversely affect the quantum of any *Inherited Estate*; and (iii) impose any material constraint on the manner and timing of any distribution of any *Inherited Estate* to eligible with-profits policyholders.

## Equity between policyholders and shareholders

5.4.1.1 Shareholders are only entitled to the *shareholder cashflows* arising on specific blocks of business in the *Heritage With-Profits Fund*. Both the cashflows and the blocks of business are defined in the *Scheme*. All profits and losses and *experience adjustments*, excluding *shareholder cashflows*, arising in the *Heritage With-Profits Fund* remain within the *Heritage With-Profits Fund* and will be utilised in accordance with the *Principles* elsewhere in this *PPFM*.

5.4.1.2 The *shareholder cashflows* referred to in Principle 5.4.1.1 can, other than in specific circumstances defined in the *Scheme*, be varied only with the consent of the Court. Any application to the Court must be accompanied by a certificate from an independent expert to the effect that, in his opinion, the proposed variation will not materially and adversely affect the reasonable expectations of policyholders. The Financial Conduct Authority also has the right to be heard by the Court. In certain limited circumstances set out in the *Scheme*, and summarised in Appendix D, different conditions apply to the variation of these shareholder entitlements.

5.4.1.3 The shareholder entitlement to the *shareholder cashflows* is subject to the *Heritage With-Profits Fund* being able to continue to meet its liabilities following the transfer of the cashflows out of the *Heritage With-Profits Fund*. The *Board* will not take any action to increase the likelihood of making the transfer of the *shareholder cashflows* if such action would be contrary to policyholders' reasonable expectations or the obligation to treat customers fairly. Subject to this the *Board* is under no obligation to take any action in managing the business in the *Heritage With-Profits Fund* that would be expected to reduce the availability of the *shareholder cashflows* to shareholders.

## 3. How With-Profits Works for Standard Life Policyholders invested in the Heritage With-Profits Fund

### 3.1 General Principles and Practices

#### 3.1.1 Principles

**3.1.1.1** All references in this *PPFM* to the “financial position of the *Heritage With-Profits Fund*” shall mean the financial position of a Notional Company, in accordance with the terms of the *Scheme*<sup>3</sup>, determined at that point in time.

For the avoidance of doubt, any projection of the financial position of the *Heritage With-Profits Fund* to a future date will reflect events that are expected, in the projection scenario in accordance with *this PPFM*, to have happened before that future date. That is, we take account of the transfer of any *shareholder cashflows* out of the Fund and any distribution of any *Inherited Estate* that are expected to have happened before the relevant future date.

**3.1.1.2** *Phoenix* aims to treat its with-profits policyholders fairly. *Phoenix* will operate the with-profits business in the *Heritage With-Profits Fund* in accordance with the *Principles* and *Practices* set out in this document and in accordance with the terms of the *Scheme*.

**3.1.1.3** Any changes to the *Principles* must be approved in advance by the *Board* and will be notified to UK with-profits policyholders normally at least three months in advance of them becoming effective.

**3.1.1.4** Any changes to the *Practices* must be approved by appropriate senior managers or committees within the authorities delegated by the *Board*, and will be submitted to the *Board* for review in due course as part of the regular monitoring of the with-profits business. UK with-profits policyholders will be notified of changes to the *Practices*. Such notification may be given in arrear but will be within a reasonable time period of the effective date of the change.

**3.1.1.5** In managing the with-profits business in accordance with this *PPFM*, the *Board* may delegate to appropriate committees or persons such of its authorities as the *Board* may determine from time to time, including the exercise of any discretion vested in the *Board*. Any such delegation will be appropriately documented.

**3.1.1.6** *Phoenix* may enter into material transactions relating to the *Heritage With-Profits Fund* provided that, in the reasonable opinion of the *Board*, the transaction is unlikely to have a material adverse effect on the interests of the *Heritage With-Profits Fund*'s existing with-profits policyholders.

**3.1.1.7** *Phoenix* may make a loan to a *connected person*, or give a guarantee to, or for the benefit of a *connected person*, using assets in the *Heritage With-Profits Fund* provided that it is on commercial terms, and, in the reasonable opinion of the *Board*, will be beneficial to the with-profits policyholders in the *Heritage With-Profits Fund*, and will not expose them to undue credit or group risk.

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<sup>3</sup> Details of which are summarised in Appendix D of this document.

### 3.1.2 Current Practices

Our *Practices* and *Principles* may change from time to time. Some factors, such as the results of reviews carried out concerning the methods and parameters used to determine with-profits *payouts*, may result in changes to *Practices*.

Other factors may cause a change in either *Principles* or *Practices*. Such factors include:

- a sustained change in external economic conditions;
- considerations of fairness – for example, between different types of product, different generations of policyholders or for different types of claim;
- a significant change in the financial position of the *Heritage With-Profits Fund*;
- a relevant legal or regulatory change.

We will seek advice from the With-Profits Committee and the *With-Profits Actuary* before making a change to the *Principles* or *Practices* although the final decision rests with the *Board*. We will consult with *SL International* before making a change to a Principle. If *Phoenix* amends any Principle in a way which *SL International* considers to have a materially adverse impact on *SL International* policyholders, then *SL International* can terminate the reinsurance treaty between *SL International* and *Phoenix*.

Following formal approval from the *Board* or relevant committee or person (consistent with the authorities delegated by the *Board*), any changes made to *this PPFM* will be documented and this documentation will be retained for at least as long as required by regulations.

The *Board* monitors compliance with *this PPFM*. In line with regulatory requirements, we will report each year to UK with-profits policyholders on compliance with *this PPFM*. A report will be prepared by the *With-Profits Actuary* with regard to the exercise of discretion and will be appended to this annual report.

We will also communicate any changes (or proposed changes) to *this PPFM* in accordance with the relevant regulatory rules relating to changes (or proposed changes) to PPFMs.

The current version of *this PPFM* and the report to UK policyholders are available on the website, [www.standardlife.co.uk/withprofits](http://www.standardlife.co.uk/withprofits)

*Phoenix* has to demonstrate to *SL International* that it complies in all material respects with its *Principles* and *Practices* and will communicate to *SL International* its compliance and any changes (or proposed change) to *this PPFM* relevant to our non-UK with-profits policyholders.

The *Board* will exercise its responsibilities in relation to the management of the *Heritage With-Profits Fund* so as to protect the interests of the with-profits policyholders. Further details of the *Principles* and *Practices* that the *Board* will observe in exercising these responsibilities are set out in *this PPFM*.

A number of the *Board's* responsibilities under *this PPFM* are delegated to appropriate committees or persons.

## 3.2 Setting Regular Bonuses

This section is relevant to *with-profits policies* for which *Phoenix* may, in its discretion, declare regular bonuses (reversionary bonuses for Conventional *with-profits policies* and their equivalents in the form of bonus growth rates for Unitised Sub-type I and Sub-type II *with-profits policies*).

This section is not relevant to Unitised Sub-type III *with-profits policies*, for which regular bonus rates do not apply (although a discretionary reduction in the fund management charge may apply - see Section 3.7.2), or to With Profits Pension Annuities for which *Declared Rates of Return* apply (see Section 3.5).

### 3.2.1 Principles

**3.2.1.1 Regular bonuses are declared at the discretion of the Board. Regular bonuses are set at levels which aim to achieve a gradual build-up in guaranteed *with-profits policy* benefits whilst not unduly constraining the investment freedom and the prospects for final bonuses. In setting regular bonus rates, the Board also takes into account the current and projected financial position of the *Heritage With-Profits Fund* and, were it necessary, would set regular bonus rates to zero.**

**3.2.1.2 Regular bonus rates are set for each relevant class of *with-profits policy* and/or sub-fund and reflect its characteristics, including any guarantees. *Phoenix* will declare separate regular bonus rates where we believe significant differences between *with-profits policy classes* and/or generations of a *with-profits policy class* and/or sub-funds make this appropriate in the interests of fairness, both to the with-profits policyholders affected and to the with-profits policyholders as a whole.**

### 3.2.2 Current Practices

Regular bonuses, in the form of reversionary bonuses and bonus growth rates, are usually declared once a year. The regular bonus rates may be zero but will never be less than zero. *Phoenix* operates different bonus series for different types or classes of *with-profits policies*. A bonus series may be closed or a new bonus series may be introduced (for new or existing *with-profits policies*) where the *Board* considers it appropriate and consistent with our aim to treat all policyholders fairly (see Section 3.2.2.4).

#### 3.2.2.1 Conventional With-Profits

##### Conventional with-profits bonus series

We currently have a number of bonus series for our Conventional business. These separate series reflect differences between the policies.

In relation to our UK business we have:

- **for Conventional life policies:** the Ordinary Series;
- **for Conventional individual pension policies:** the Reversionary Series; and
- **for Conventional group pensions schemes:** the Reversionary Bonus Series.

In relation to our business in Ireland we have:

- **for Conventional life policies:** the Irish Ordinary Series; and
- **for Conventional pension policies:** the Irish Reversionary Series.

There is only one series of bonus rates applicable to German Conventional with-profits pensions contracts. This is business that was transferred from Hannover Standard Life Limited (“HSL”), a German joint venture that closed in 2003.

## How often and in respect of what period are regular bonus rates on Conventional with-profits policies declared?

For these bonus series we usually declare regular bonus rates on Conventional business once a year. There are two rates; one that applies to the *guaranteed benefits* excluding any bonus amounts previously added and one that applies to bonus amounts previously added. Regular bonuses in general are in respect of the previous *bonus year*, except for group pension schemes where they are in respect of the scheme year ending on or after the 1<sup>st</sup> March after the bonus declaration and for ex-HSL policies where they are in respect of the previous calendar year.

## How are regular bonus rates on Conventional with-profits policies determined?

**For UK Conventional life policies** we investigate what rates of regular bonus are affordable in the long term and consistent with the desire not to unduly constrain investment freedom and the prospects for final bonuses (ignoring any additional final bonus that may result from any distribution of any *Inherited Estate*).

This investigation involves projecting both *asset shares* and *guaranteed benefits* for a range of relevant policies. These projections allow for our expectation of the returns the assets in the *Heritage With-Profits Fund* will generate along with other assumptions, including an allowance for expected future deductions from *asset shares*. This investigation also takes into account other factors, such as the projected future financial position of the *Heritage With-Profits Fund* and the aim that changes in regular bonus rates should normally be gradual (see Section 3.2.2.3).

**For UK Conventional individual pension policies**, regular bonus rates are set at broadly consistent levels with Conventional life policies, taking into account the different tax treatment.

**For UK Conventional group pension schemes**, consideration is given when setting regular bonus rates to the historic premium bases and to our expectation of the return the assets in the *Heritage With-Profits Fund* will generate.

Regular bonus rates for **Irish Conventional policies** are set consistently with the UK. For the small amount of **ex-HSL** business they are set with reference to the smoothed return on the assets backing that business over the previous calendar year.

**For all Conventional Policies**, if premiums cease before the date specified (if any) in the contractual terms and conditions and the policy becomes what is referred to as "Paid-Up" then separate regular bonus rates (which may be the same as those for premium paying policies, but are not necessarily so) apply from the date the premiums ceased. These regular bonus rates are determined in the same way as for premium paying policies.

Currently for UK Conventional life and pension "Paid-Up" policies, the same regular bonus rate is applied to both the reduced *guaranteed benefit* excluding any bonus amounts previously added and to bonus amounts previously added. This is the regular bonus rate which applies to the *guaranteed benefits* excluding any bonus amounts previously added to premium-paying policies.

## Interim regular bonus on Conventional with-profits policies

For Conventional policies, claims are usually credited with "interim" regular bonus for the period between the end of the *bonus year* (or scheme year for UK Conventional group pension schemes) to which the last declared regular bonus rates apply and the date of claim.

Interim regular bonus rates are determined in a similar manner to other Conventional regular bonus rates, but may not be the same. One of the additional factors that may be taken into account is the level of regular bonus expected to be declared at the next declaration. Interim regular bonus rates are not guaranteed and may be changed without notice.

### 3.2.2.2 Unitised With-Profits

#### Notional sub-funds

**For Unitised Sub-type I and Unitised Sub-type II policies**, each policy is allocated units in a notional *sub-fund* or *sub-funds*. The notional *sub-fund* or *sub-funds* that apply to any given policy may depend on the *class of policy*, when the premium(s) were paid and/or when the policy was sold.

Except for policies invested in the Pension Inflation Plus Fund, Unitised Sub-type I and Unitised Sub-type II policies have various guaranteed minimum unit price growth rates and various bonus growth rates (which may be zero, but can never be negative). Unit price growth rates applicable to particular unitised with-profits policies are provided in Appendix A for UK policyholders and Appendix B for Irish policyholders.

For contracts in Germany and Austria, in addition to a minimum unit price growth rate of 0%, there are guarantees that are specified as guaranteed returns on allocated premiums. Details are provided in Appendix C.

#### How are regular bonus rates applied to Unitised with-profits policies?

Except for policies invested in the Pension Inflation Plus Fund, regular bonus rates on Unitised Sub-type I and Unitised Sub-type II policies are applied daily and reflected in the unit bid price for the appropriate notional *sub-funds*. The rate of change in price for each *class of policy* in each notional *sub-fund* depends on the guaranteed minimum unit price growth rate and the regular bonus rate and is not directly linked to the investment performance of the assets backing that *class of policy* in that notional *sub-fund*. When benefits are taken, a final bonus may apply in addition to the *unit value*, or a Unit Price Adjustment may apply (i.e. the unit price may be reduced), see Section 3.3.

Regular bonus rates do not apply to the Pension Inflation Plus Fund or to Unitised Sub-type III policies.

#### How often are bonus growth rates on Unitised with-profits policies declared?

Bonus growth rates are usually declared once a year. Once declared, bonus growth rates continue to apply until the next declaration.

#### How are bonus growth rates on Unitised with-profits policies determined?

For **Unitised Sub-type I pension policies and Unitised Sub-type II policies** we investigate what rates of regular bonus are affordable in the long term and consistent with the desire not to unduly constrain investment freedom and the prospects for final bonuses (ignoring any additional final bonus that may result from any distribution of any *Inherited Estate*).

This investigation involves projecting both *asset shares* and *guaranteed benefits* for a range of relevant policies. These projections allow for our expectation of the returns the assets in the *Heritage With-Profits Fund* will generate along with other assumptions, including an allowance for expected future deductions from *asset shares*. This investigation also takes into account

other factors, such as the projected future financial position of the *Heritage With-Profits Fund* and the aim that changes in regular bonus rates should normally be gradual (see Section 3.2.2.3).

In general for UK and Irish life policies, the regular bonus rates are set at broadly consistent levels with those for Unitised pension policies with the same asset mix, taking into account the different tax treatment.

Regular bonus rates for German and Austrian life policies are the same as those for German and Austrian unitised pension policies with the same asset mix.

### 3.2.2.3 Changes to Regular Bonus Rates

For all *with-profits policies*, we aim to ensure that any changes to regular bonus rates are not too great from declaration to declaration. Currently our practice is not to change regular bonus rates by more than 0.5% (for example from 2.0% to 1.5%) at any declaration.

Notwithstanding our aim to only make changes gradually over time, there may be circumstances when more significant changes are needed. Such circumstances might include, for example, significant changes in the prevailing economic climate, the regulatory environment or the financial position of the *Heritage With-Profits Fund*.

### 3.2.2.4 Introduction of New Regular Bonus Series

A Conventional with-profits bonus series or Unitised with-profits notional *sub-fund* may be closed or a new bonus series or notional *sub-fund* may be introduced if the *Board* considers it appropriate and consistent with our aim to treat all policyholders fairly. Any such new bonus series or notional *sub-fund* may apply to new policies only or to the whole or part of existing policies. For example a new notional *sub-fund* may apply only to with-profits premium increases, including single premiums and transfer values, and to switches into with-profits from non with-profits funds.

Examples of when this may be considered appropriate include:

- if levels of guarantee costs for different groups of policies become sufficiently different;
- if the mix of assets backing different groups of policies becomes sufficiently different;
- if a new policy is introduced which is sufficiently different from existing *with-profits policies*; or
- if the tax regime changes.



### 3.3 Setting Payouts - Overview

This Section describes *Phoenix's* approach to determining the amounts payable under *with-profits policies*. This Section, together with Section 3.4, explains when final bonuses may apply and how the level of any final bonus is set. Both Sections deal separately with the different types of *with-profits policies* described earlier (see Section 1 Introduction to Standard Life With-Profits). It should be noted, however, that, even within a particular *with-profits policy* type, final bonus rates can vary by, for example, product, term in force, level of guarantees and type of claim. For minor classes of *with-profits policies* a more approximate approach may be taken (see Section 3.4.1.2).

This Section also covers how *Phoenix* determines the extent to which *investment returns* should be smoothed when setting *payouts*.

#### 3.3.1 Principles

**3.3.1.1** *Phoenix's* aim is that, subject to meeting all contractual obligations and maintaining an adequate financial position for the *Heritage With-Profits Fund*, *payouts* on a *with-profits policy* (including any final bonus applying) should fairly reflect the experience of the *Heritage With-Profits Fund* applicable to such a policy, after any adjustments for *smoothing*, and any distribution of the *Inherited Estate* deemed appropriate by the *Board*.

**3.3.1.2** In order to determine *payout* levels (including amounts and rates of final bonus and/or Unit Price Adjustments) *Phoenix* uses a variety of methods reflecting the different *classes* of *with-profits policy* and/or types of unit *sub-fund*.

**3.3.1.3** When setting *payout* levels, *Phoenix* seeks to ensure fair treatment between those with-profits policyholders who choose to withdraw and those who remain.

**3.3.1.4** Other than for minor *classes* of *with-profits policies* (constituting less than 10% of total with-profits liabilities) where alternative methods may be used, see Section 3.4.1.2, in order to ensure equity between different groups of *with-profits policies*, *Phoenix* determines *payouts* (including final bonus rates and/or Unit Price Adjustments) by reference to *asset shares*.

**3.3.1.5** In calculating with-profits *asset shares*, *Phoenix* will make fair deductions where appropriate to reflect its assessment of the cost of guarantees.

**3.3.1.6** For *with-profits policies* where *asset shares* are determined on an expense basis, there will be a 0.5% per annum deduction as a contribution to the capital of the *Heritage With-Profits Fund*.

**3.3.1.7** Other than those described in this *PPFM*, no deductions will be made from the *asset shares* of *with-profits policies* unless and to the extent that the *Inherited Estate* has been exhausted and the expected value of future *shareholder cashflows* has been applied to meet liabilities of the *Heritage With-Profits Fund* (other than the liability to make a transfer to shareholders).

**3.3.1.8** In normal circumstances, *Phoenix* seeks to smooth *payouts* to with-profits policyholders at the time of claims due to maturity.

**3.3.1.9** *Phoenix* may, at its discretion, also provide some *smoothing* of *payouts* for death claims, and some or all types of withdrawal, at the time of payment.

3.3.1.10 *Phoenix* aims to operate *smoothing of payouts* in such a way as to be neutral for with-profits policyholders as a whole over time, but the *payout* applicable for any individual policyholder may be impacted positively or negatively by the application of *smoothing*. *Smoothing* formulae will be set from time to time to take into account current and expected economic conditions.

3.3.1.11 The *Board* regularly monitors the expected and actual *smoothing* profits and losses. These profits and losses will normally be reflected in *payouts* of the remaining with-profits policyholders.

3.3.1.12 The methodology and parameters used in *payout* calculations may, of necessity, involve some measure of approximation. *Phoenix* reviews regularly the methodology and parameters used and sets parameters on bases appropriate for the with-profits *class* and/or unit *sub-fund* concerned.

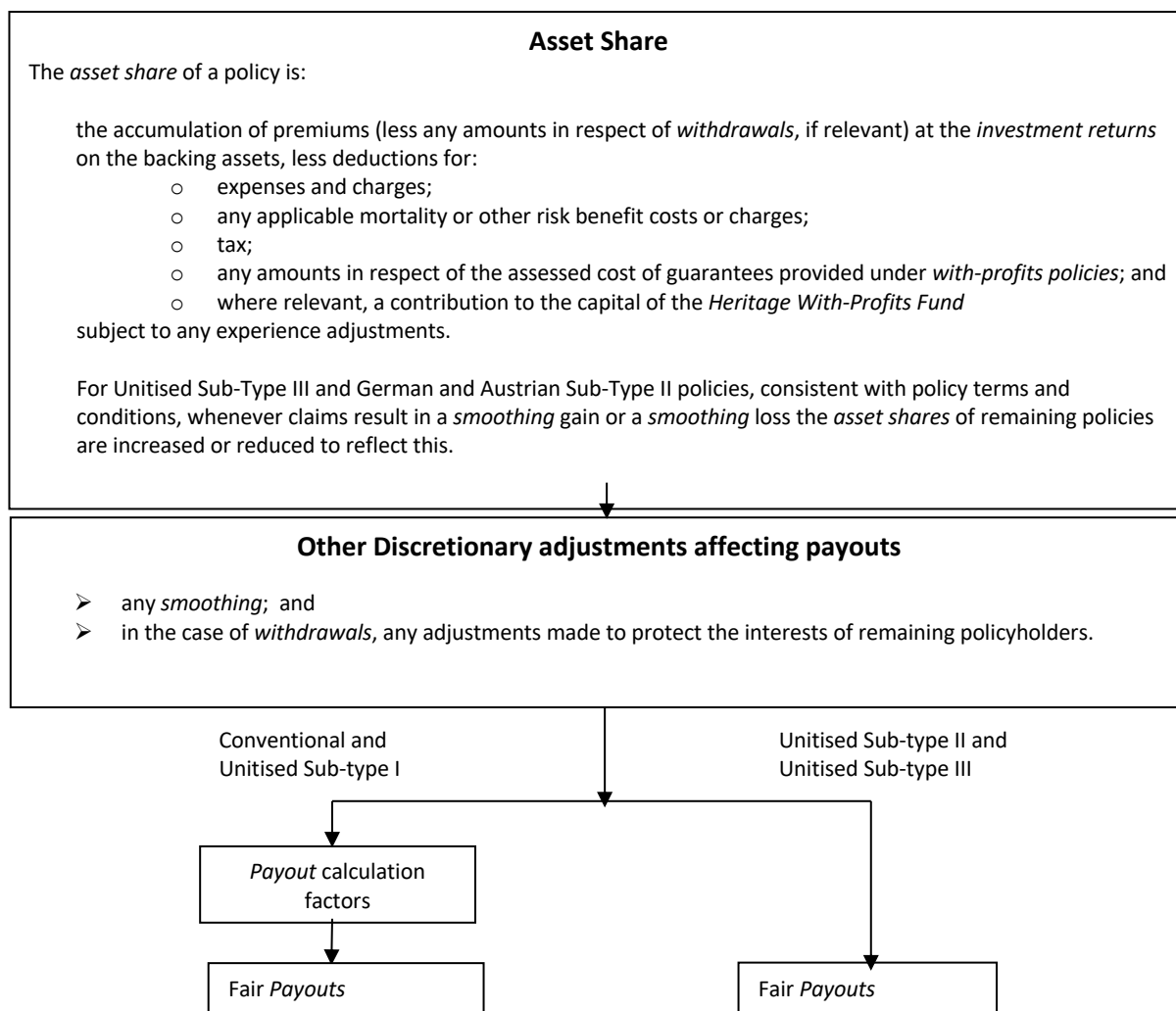
3.3.1.13 *Phoenix* may change historical parameters applied in *asset share* calculations in the light of subsequent information about actual experience, subject to the requirement to treat policyholders fairly.

3.3.1.14 Variations between the historical parameters and the actual experience of *with-profits policies* may be directly attributed to, or met by, the *asset shares* of *with-profits policies* through *experience adjustments*.

### 3.3.2 Current Practices

#### 3.3.2.1 Asset Shares, Smoothing and Payouts

*Asset shares* are used as a tool to help calculate fair *payouts*. The following diagram illustrates how the various components of *asset shares* (including both regular and discretionary adjustments), together with further discretionary adjustments the *Board* has decided as appropriate, are used to determine fair *payouts*.



In addition, when a claim is made there may be further positive adjustment in respect of any distribution of any *Inherited Estate* as set out in Section 5.2.

The *payout* for any claim will be no lower than any *guaranteed benefit* payable in accordance with the terms and conditions of the policy for that type of claim.

**For Conventional policies**, *asset shares* are calculated for relevant *representative* policies, each with characteristics that reflect a group of Conventional policies. These *asset shares* (after any *smoothing* and any other discretionary adjustments are applied) are used in the determination of payout calculation factors, which may take the form of final bonus rates, that are used to determine final bonuses and *payouts*. We set payout calculation factors for each group of Conventional policies at least once a year and may set them more frequently to meet our aims set out in *this PPFM*, for example to maintain fairness between generations of policyholders.

**For Unitised Sub-type I policies**, *asset shares* are calculated for relevant *representative* policies, each with characteristics that reflect a group of Unitised Sub-Type I policies. These *asset shares* (after any *smoothing* and any other discretionary adjustments are applied) are used in the determination of payout calculation factors, which may take the form of final bonus rates, that are used to determine final bonuses (or Unit Price Adjustments) for *payouts*. We set payout calculation factors for each group of Unitised Sub-type I policies at least once a year and may set them more frequently to meet our aims set out in *this PPFM*, for example to maintain fairness between generations of policyholders.

**For Unitised Sub-type II policies**, *payouts* are determined directly from individually calculated *asset shares* (after any *smoothing* and any other discretionary adjustments are applied). This calculation will determine the final bonus (or Unit Price Adjustment) for each *payout*.

The payouts for some Irish business are calculated in a consistent way as above but do not have investment guarantees, regular bonuses or final bonuses.

**For Unitised Sub-type III policies**, *payouts* are determined directly from individually calculated *asset shares* (after any *smoothing* and any other discretionary adjustments are applied).

The use of *representative* policies, to determine payout calculation factors for Conventional policies and for Unitised Sub-type I policies, may result in higher or lower *payouts* than if *payouts* were based on *asset shares* individually calculated for each policy. For example the circumstances where this may result in a lower *payout* include:

- the *investment return* since the policy was taken out is higher than the *investment return* since the *representative* policy was taken out because of small differences in the dates of investment;
- the policy's size is greater than that of the *representative* policy (because fixed costs have a smaller impact on bigger policies); and
- the age of the policyholder is lower than the age for the *representative* policy (because mortality costs are generally lower at younger ages).

## **Mortgage Endowment Promise**

For policies eligible for a payment under the Mortgage Endowment Promise including those reinsured from *SL International*, an additional payment may be made on *maturity* subject to and in accordance with the terms of the Mortgage Endowment Promise as set out in the *Scheme*. The relevant provisions of the *Scheme* are summarised in Appendix D.

## **Investment return and asset shares**

The most important influence on *asset shares* is usually the *investment return* on the assets held to back them. *Phoenix* aims to provide a return to each with-profits policyholder that reflects the investment performance of the with-profits assets backing the *asset shares* for their *class of policy* and / or notional *sub-fund(s)* over the period of their investment after any *smoothing*. The *investment returns* used in *asset share* calculations are, where relevant, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees.

The return to with-profits policyholders will however also reflect the impact of various deductions, details of which are set out in Section 3.4, and of any distribution of the *Inherited Estate*.

## Smoothing

*Smoothing* can help to reduce the effects of fluctuations in *investment returns* that arise shortly before a claim is paid.

In normal circumstances we apply some *smoothing* on *maturity* and we may apply some *smoothing* on death. The extent of any *smoothing* on *maturity* and death claims can vary by product, *sub-fund*, and *with-profits policy* type. In particular the death benefit for a With Profits Bond is based on the *withdrawal* benefit and so for these policies the amount of *smoothing* on death claims depends on the amount of *smoothing* on *withdrawal payouts*.

We may apply some *smoothing* on *withdrawal*. The extent, if any, to which we choose to do so depends on a number of factors, including:

- the type of *withdrawal*;
- the type of product, *sub-fund*, and *with-profits policy*;
- whether we experience or reasonably expect to experience a significant amount of money to be leaving with-profits as a result of either a request to surrender a large number of policies, for example from one or more investors who hold traded endowment policies, or a large number of policyholders surrendering their policies, particularly if there has been a rapid fall in the value of the assets in the *Heritage With-Profits Fund*, or when *investment returns* from these assets have been poor for a sustained period;
- the extent to which maturity *payouts* are currently being smoothed; and
- the financial position of the *Heritage With-Profits Fund*.

Further information on our approach to *smoothing* is set out in Section 3.3.2.7.

The method used to calculate with-profits *payouts*, including final bonuses where applicable, varies by class of with-profits business (see below).

## Retrospective changes to asset shares

*Phoenix* may change historical parameters applied in *asset share* calculations in the light of subsequent information about actual experience but only if to do so would improve the accuracy of *asset share* calculations and be consistent with treating policyholders fairly.

### 3.3.2.2 Setting Payouts: Conventional With-Profits Policies

#### **Maturity (including claims currently being treated as maturities)**

At *maturity*, the benefits payable under Conventional *with-profits policies* are subject to a minimum of the *guaranteed benefits* set out in the relevant contractual terms and conditions together with the sum of regular bonuses added to date, provided that all premiums have been paid when due. In addition to these *guaranteed benefits*, a final bonus may be payable.

We set final bonus rates at least once a year and may set them more frequently if necessary to meet our aims set out in *this PPFM*, for example to maintain fairness between generations of policyholders.

Final bonus rates are set with reference to appropriate *representative* maturing Conventional policies. We compare the *guaranteed benefits* for these relevant *representative* policies with the corresponding *asset shares*, after allowing for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate. Subject to the further considerations described below, final bonus rates are set at levels so as broadly to close any gap between the *guaranteed benefits* of the relevant *representative* policies and the *asset shares* (after allowing for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate).

The cost to the *Heritage With-Profits Fund* of final bonuses is assessed for affordability, in light of the financial position of the *Heritage With-Profits Fund* and obligations to policyholders (including the requirement to treat customers fairly). This means that final bonus rates will not be reduced solely in order to facilitate the making of transfers of *shareholder cashflows*.

#### **Maturity for Paid-Up Conventional Policies**

For some Conventional pension policies there is a direct relationship between the *guaranteed benefits* at retirement and the actual premiums paid. For example, under a Conventional deferred annuity policy (Stanplan M) each premium paid purchases additional guaranteed annuity benefits.

For other Conventional pension policies the *guaranteed benefits* at retirement depend on all the regular premiums having been paid as specified under the contractual terms and conditions. If these premiums cease before the date specified in the contractual terms and conditions and the policy becomes what is referred to as “Paid-Up”, a reduced *guaranteed benefit* is calculated. Separate regular bonus rates (which may be the same as those for premium paying policies, but are not necessarily so) apply from the date the premiums ceased (see Section 3.2.2.1).

Similarly, under a Conventional life policy, if the premiums cease before the original maturity date and the policy becomes “Paid-Up” then the *guaranteed benefit* will be reduced and separate regular bonus rates apply (see Section 3.2.2.1).

Paid-Up policies remain eligible for a final bonus.

Currently, the same final bonus rates are used for paid-up and premium-paying policies. However, for paid-up policies we may apply a reduction factor that depends on when the policy was made paid-up.

## Death

For Conventional policies where a final bonus may be payable on death, the rate that currently applies is the final bonus rate determined for maturities of the same duration. For paid-up policies we may apply a reduction factor that depends on when the policy was made paid-up.

## Withdrawal (partial or full)

Our current intention is that *withdrawal payout* values for the *representative* policies should be broadly in line with their *asset shares*, adjusted to allow for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate.

As noted in Section 3.3.2.1, the effect of any *smoothing* on *withdrawals* could be different to that on *maturity* claims.

Other discretionary adjustments might also be different on *withdrawal* to those on *maturity*. This is because we wish to ensure that policyholders who choose to withdraw do so on terms which are both fair to them and also fair to with-profits policyholders who remain. For example, higher than normal levels of *withdrawals* for policies where initial expenses have not yet been fully recouped through the applicable charging basis could lead to losses that may be allocated across such withdrawing policies. Similarly, in the calculation of *withdrawal payouts* we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had the policy remained invested in with-profits. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that class of business at the date of *withdrawal*.

### 3.3.2.3 Setting Payouts: Unitised Sub-type I Policies

#### Maturity (including claims currently being treated as maturities)

For Unitised Sub-type I life policies, provided all premiums have been paid in accordance with the contractual terms and conditions, the minimum *payout* on *maturity* is the *unit value* at the date of maturity.

The *unit value* is the bid price of the relevant notional *sub-fund* units multiplied by the number of units allocated to the policy concerned. As described in Section 3.2.2.2, the bid price of units increases daily by the guaranteed minimum unit price growth rate and any applicable bonus growth rate.

For Unitised Sub-type I pension policies, the minimum *payout* on *maturity* is, except in circumstances when a Unit Price Adjustment applies (see below), the *unit value* less any outstanding initial unit charges.

In both cases, in addition to the *unit value*, a final bonus may be payable. The final bonus rates are designed broadly to close any gap between the *unit value* of the relevant *representative* policies and their *asset shares* (after allowing for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate), where this is higher.

As for Conventional *with-profits* policies, we set final bonus rates at least once a year and may set them more frequently to meet our aims set out in *this PPFM*, for example to maintain fairness between generations of policyholders.

Also, as for Conventional *with-profits policies*, the cost to the Heritage With-Profits Fund of final bonuses is assessed for affordability in light of the financial position of the *Heritage With-Profits Fund* and obligations to policyholders (including the requirement to treat customers fairly). This means that final bonus rates will not be reduced solely in order to facilitate the making of transfers of *shareholder cashflows*.

For Unitised Sub-type I life policies the final bonus rates are currently expressed as a percentage of the *unit value* at cancellation, with the percentage varying according to the number of years for which the policy has remained invested in the notional *sub-fund*.

For Unitised Sub-type I pension policies the final bonus rates are currently expressed as a percentage of the accrued growth in the value of units, with the percentage varying according to the *bonus year* in which the units were allocated. The percentage applying to units on the day they are allocated will be zero. To maintain fairness between existing and new with-profits investments, for sub-funds in to which increments, single premiums, transfers and switches can be made our current practice is to continue to apply a rate of zero to units for an initial period after they are allocated. Depending on when in a *bonus year* they are allocated this will be for a period of between 15 and 27 months.

### **Maturity for Paid-Up Unitised Sub-type I Policies**

The same final bonus rates currently apply to Unitised Sub-type I policies that have become Paid-Up (i.e. where premiums ceased before the date specified in the contractual terms and conditions) as apply to Unitised Sub-type I policies where all premiums have been paid.

For Unitised Sub-type I life policies that are Paid-up, we may, in accordance with the contractual terms and conditions, apply a Unit Price Adjustment (see below) on *maturity* if the fair payout plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the policy's *unit value*.

### **Death**

For Unitised Sub-type I life policies the *payout* on death is the higher of:

- the specified sum assured; and
- the *unit value* at date of death plus any final bonus, currently based on the rate that would apply were the policy maturing on the same day.

For Unitised Sub-type I pension policies where a final bonus may be payable on death, currently the same rates apply as if the policy had matured on the date of death.

### **Withdrawal**

Where the fair payout on *withdrawal* plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the corresponding *unit value*, we will apply an appropriate Unit Price Adjustment to bring the *unit value* into line with the fair payout plus any enhancement. Where the fair payout plus any enhancement is higher than the corresponding *unit value*, the difference will be paid as a final bonus.

The final bonus rates (if any) that apply to *withdrawals* may be different to those for maturing policies of the same duration because the effect of any *smoothing* on *withdrawals* could be different to that on *maturity* claims (see Section 3.3.2.1) and other discretionary adjustments might also be different on *withdrawals* to those on maturities (see the discussion in relation to Conventional *with-profits policies*, which applies equally to Unitised Sub-type I policies, in the sub-section on *withdrawals* in Section 3.3.2.2).



## Unit Price Adjustments for Unitised Sub-type I policies

In certain circumstances as specified in the contractual terms and conditions, we may apply an adjustment to the unit price (a “Unit Price Adjustment”) when determining *payouts* on Unitised Sub-type I policies or when units are allocated, for example on payment of a transfer value or fund switch.

In summary, the circumstances in which a Unit Price Adjustment may be applied include:

- Life – on *withdrawal* or, if the policy has been made Paid-Up, on *maturity*;
- Pensions – where the units:
  - are allocated as a result of a fund switch or payment of a transfer value;
  - for some types of policy, are allocated as a result of payment of a single premium or, for other types of policy, are allocated in the five years before a vesting date as a result of the payment of a single premium or any other premium;
  - are cancelled on a vesting date if the proceeds, after any cash lump sum is taken, are not immediately used to purchase one or more annuities;
  - are cancelled on a vesting date which:
    - for units in the Pension With Profits Fund, Pension Millennium With Profits Fund, Pension Millennium With Profits 2006 Fund and Pension Inflation Plus Fund, is more than five years prior to the originally selected vesting date; or
    - for other with-profits units, is any date other than the originally selected vesting date (for some policies the originally selected vesting date is referred to as the “Intended Vesting Date”);
  - are cancelled on a vesting date if those units were allocated in the five years before that date as a result of the payment of a transfer value or of a switch of funds or, for some types of policy, as a result of payment of a single premium; or
  - are cancelled to transfer the proceeds to another policy or pension scheme or to discharge a court order.

A Unit Price Adjustment will only be applied when the fair payout of the policy plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the *unit value*. The purpose of the Unit Price Adjustment will be to bring the *unit value* in line with the fair payout plus any enhancement.

### 3.3.2.4 Setting Payouts: Unitised Sub-type II Policies

#### **Maturity (including claims currently being treated as maturities)**

German and Austrian Unitised Sub-type II with-profits products provide a guaranteed lump sum and/or annuity value at *maturity*.

The With Profits Bond has no maturity date: it is a “whole of life” policy. *Payouts* other than on death and certain *regular withdrawals* (see below) are treated as *withdrawals*.

The Capital Savings Plan and the MoneyWorks Plan in Ireland are also whole of life contracts and have no maturity dates. *Payouts* other than on death are treated as *withdrawals*.

For other Unitised Sub-type II policies, on the *maturity* date of each policy we calculate the *unit value* and the fair payout based on the policy’s *asset share* after allowing for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate (see Section 3.3.2.1).

For UK and Irish life policies where all the specified premiums have been paid in accordance with the contractual terms and conditions, the minimum maturity payout is the *unit value*. For German and Austrian policies it is the greater of the *unit value* and the guaranteed lump sum.

For UK and Irish pension policies, the minimum *payout on maturity* is, except in circumstances when a Unit Price Adjustment applies (see below), the *unit value*. There is no Unit Price Adjustment at *maturity* in Germany and Austria and the minimum *payout on maturity* is the greater of the *unit value* and the guaranteed lump sum.

In all cases, in addition to the *unit value*, a final bonus may be payable where the fair payout plus any enhancement in respect of any distribution of any *Inherited Estate* is greater than the *unit value*, the difference will be paid as a final bonus.

### **Maturity for Paid-Up Unitised Sub-type II Policies**

In general the fair payout for each policy is based on its individually calculated *asset share* (after any *smoothing* and any other discretionary adjustments are applied) and automatically takes account of the policy's premium history, and so separate calculations for Paid-Up policies are not required.

For UK and Irish life policies where a policyholder has ceased paying regular premiums before the date specified at outset, we may, in accordance with the contractual terms and conditions, apply a Unit Price Adjustment (see below) on *maturity* if the fair payout plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the policy's *unit value*. In general there is no Unit Price Adjustment at maturity in Germany and Austria.

## Death

For the With Profits Bond the death benefit is equal to a multiple of the *payout* that would be made on *withdrawal* subject to a minimum of a multiple of the *unit value*, at the date of death. These multiples are set out in the terms and conditions of the policy.

We may also apply different degrees of *smoothing* on death claims and withdrawal (see below) to that on *maturity* claims.

For other Unitised Sub-type II policies, the death benefit is the higher of:

- the specified sum assured; and
- the *unit value* at the date of death (plus any final bonus, currently based on that which would apply were the policy maturing on the same date).

Where such policies do not have specified sums assured the payment on death is currently based on the payout that would apply were the policy maturing on that date.

Policies in Germany and Austria may have an additional guarantee on death such that the death benefit will be the higher of the payout calculated as described above and:

- a multiple of the payout on *withdrawal*; or
- a return of premiums.

Details of the guarantees are set out in the terms and conditions of the policy.

## Withdrawal

Where the fair payout on *withdrawal* plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the corresponding *unit value*, we will apply an appropriate Unit Price Adjustment to bring the *unit value* into line with the fair payout plus any enhancement (see below for special conditions that apply to *regular withdrawals* from With Profits Bonds). Where the fair payout plus any enhancement is higher than the corresponding *unit value*, the difference will be paid as a final bonus.

The effect of any *smoothing* and any other discretionary adjustments on *withdrawals* could be different to that on *maturity* claims (see Section 3.3.2.1 and the discussion in relation to Conventional *with-profits policies*, which applies equally to Unitised Sub-type II policies, in the sub-section on *withdrawals* in Section 3.3.2.2).

Some Capital Savings Plan and the MoneyWorks Plan policyholders in Ireland may also have a guaranteed surrender date, at which the minimum payment is the *unit value* and a Unit Price Adjustment will not be applied.

Some German and Austrian Unitised Sub-type II with-profits products provide guaranteed surrender values. Further some products guarantee that, on one or more dates or during a period between two dates, a Unit Price Adjustment will not be applied.

## Regular Withdrawals

*Regular withdrawals* may be taken with certain Unitised Sub-type II with-profits products, for example by the policyholder from a With Profits Bond. Under certain conditions, there is a guarantee that a Unit Price Adjustment will not apply on *regular withdrawals* up to the Guaranteed Regular Withdrawal Amount (“GRWA”). This means that a minimum of the *unit value* is used to determine how many units need to be cancelled to pay for a *regular withdrawal* up to the policyholder’s GRWA, whether or not a Unit Price Adjustment would apply on *regular withdrawals* over this amount.

The GRWA is the lower of:

- the relevant level of *regular withdrawals*; and
- the current Bonus Withdrawal Amount.

The relevant level of *regular withdrawals* is set at the outset of the policy to be the level of *regular withdrawals* chosen then. It will reduce to reflect any decrease in the level of *regular withdrawals*, but we reserve the right not to increase the GRWA when the level of *regular withdrawals* is increased.

The Bonus Withdrawal Amount is set at the outset of the policy and is the bonus growth rate applying at that date multiplied by the *unit value*. The Bonus Withdrawal Amount is recalculated at least every year, following a declaration of the relevant regular bonus growth rate. In addition, the Bonus Withdrawal Amount is recalculated if the policyholder pays an increment to, or makes *withdrawals* other than *regular withdrawals* from, their policy.

### **Unit Price Adjustments for Unitised Sub-type II policies**

In certain circumstances as specified in the contractual terms and conditions, we may apply an adjustment to the unit price (a "Unit Price Adjustment") when determining *payouts* on Unitised Sub-type II policies or when units are allocated.

A Unit Price Adjustment will only be applied when the fair payout plus any enhancement in respect of any distribution of any *Inherited Estate* is less than the *unit value* of a policy at the date of claim. The purpose of the Unit Price Adjustment will be to bring the *unit value* into line with the fair payout plus any enhancement.

The exact conditions in which *Phoenix* can apply a Unit Price Adjustment may depend on the type of policy and the fund it is invested in. The conditions may include:

- 1) For Irish pension policies, whenever single contributions are paid.
- 2) Whenever units are switched in to or out of a unitised with-profits fund.
- 3) For Irish pension policies, on retirement before age 60.
- 4) For Irish pension policies, when the policyholder takes the proceeds of the policy, for units allocated in respect of any single premium paid during the previous five years.
- 5) When *withdrawals* (regular or single) are made from the fund, except on *regular withdrawals* up to the GRWA (see above); and
- 6) For UK and Irish life policies, if the policy has been made Paid-Up, on *maturity*.

#### **3.3.2.5 Setting payouts: Unitised Sub-type III Policies**

##### **Maturity**

For Unitised Sub-type III policies, there are no minimum growth guarantees or final bonuses. The fair payout, which allows for the effect of any *smoothing* (see Section 3.3.2.7), changes daily and depends directly on the investment performance of the relevant assets, the deductions made (for example for charges), and any other discretionary adjustments the *Board* has decided are appropriate (see Section 3.3.2.1). Any enhancement in respect of any distribution of any *Inherited Estate* is in addition to the fair payout. German and Austrian *Sucess* policies are not eligible for any distribution from the *Inherited Estate*.

The fair payout can go down as well as up.

The fair payout for each Unitised Sub-type III policy is based on its individually calculated *asset share* (after any *smoothing* and any other discretionary adjustments are applied) and automatically takes account of the policy's premium history, and so separate calculations for Paid-Up policies are not required.

## Death

The death benefit for Unitised Sub-type III policies is currently calculated in the same way as the payout on *maturity*.

For German and Austrian Suxsess policies there may be a guaranteed minimum payout on death, for example the sum assured or a return of premiums.

## Withdrawal

For Unitised Sub-type III policies, the calculation of the *payout on withdrawal* is usually the same as that were the policy maturing on that day. In some circumstances, however, we may operate different degrees of *smoothing* on *withdrawals*, depending on the type of *withdrawal*, if, for example, this is considered appropriate to maintain fairness between those policyholders who leave and those who remain to the maturity date.

### 3.3.2.6 Setting payouts: With Profits Pension Annuity

#### UK and Ireland

Final bonus does not apply for the With Profits Pension Annuity. Instead the annuity level is reviewed at least once a year. For details of how the annuity level is reviewed, see Section 3.5.

For a UK policyholder that wishes to move out of with-profits, the annuity is converted into a Compulsory Purchase Annuity by dividing the policyholder's fair share of the relevant with-profits assets by an appropriate annuity rate, where the share of the relevant with-profits assets is based on an *asset share*, having applied whatever discretionary adjustments the *Board* has determined should apply to With Profits Pension Annuities at that time. *Investment returns* will not be smoothed in this calculation.

There is no option under the With-Profits Retirement Annuity in Ireland to convert to a non with-profits annuity.

#### Germany and Austria

The with-profits variant of Freelax Sofort determines a guaranteed annuity at the start of the annuity payment phase, payable for life.

Any bonuses are declared on an annual basis and applied on the policy anniversary to increase the guaranteed annuity payable. Once added bonus increases cannot be removed.

It is not possible to switch from a with-profits annuity into a non with-profits annuity.

### 3.3.2.7 Approach to Smoothing

*Smoothing* can help to reduce the effects of fluctuations in *investment returns* that arise shortly before a claim is paid. We aim to smooth out short-term fluctuations in *investment returns* over time for maturing policies and we may also do so on *withdrawal*. However, we cannot fully protect with-profits policyholders from the effects of such short-term changes.

The extent, if any, to which *Phoenix* is able to smooth *payouts* depends on the financial position of the *Heritage With-Profits Fund*. There may be circumstances of financial stress in which we would not smooth out fluctuations in *investment returns*. Alternatively, we may continue to apply some investment return *smoothing* for maturing policies, but less or no investment return *smoothing* for *withdrawals*. Such differences would normally only occur if investment return *smoothing* would result in a higher payout value.

*Smoothing* will never reduce any *guaranteed benefits* that may apply.

### **Smoothing for Conventional and Unitised Sub-type I policies**

For *payouts* in respect of Conventional and Unitised Sub-type I policies, *smoothing* may currently be applied through:

- *smoothing of investment returns* to calculate initial smoothed values from *asset shares* for relevant *representative* policies; and
- adjustment of these initial values when determining payout calculation factors.

Our aim is that *payouts* for the *representative* policies, before any distribution from the *Inherited Estate*, should be between 80% and 125% of their *asset share*. However, in some circumstances, *payout* values for the *representative* policies may fall outside this range, for example after a sudden large change in asset values. *Representative* policies may have different *payout* values (as a percentage of *asset share*) within this range. This range allows *smoothing* to operate without undue constraints in normal circumstances.

### **Smoothing for Unitised Sub-type II and Sub-type III policies**

For Unitised Sub-type II and Sub-type III policies, where *payouts* are determined from individually calculated *asset shares* (rather than by using relevant *representative* policies), *smoothing* may be applied through:

- *smoothing of investment returns* to calculate initial smoothed values from *asset shares*; and
- adjustment of the resulting values when determining *payout* values.

Our aim is that *payouts* for these policies, before any distribution from the *Inherited Estate*, should be between 80% and 125% of their *asset share*. Individual policies or *classes of policies* may have different *payouts* (as a percentage of *asset share*) within this range. This range allows *smoothing* to operate without undue constraints in normal circumstances.

### **Treatment of smoothing profits and losses – Policies other than Unitised Sub-type III**

The aim of our approach to *smoothing* is that its effect should be neutral over time to with-profits policyholders as a whole.

For *with-profits policies* other than Unitised Sub-type III, this is normally achieved by applying adjustments to the *smoothing of payouts*. For any policy, these adjustments will normally take account of *smoothing* gains and losses on with-profits *payouts* made over the period it has been invested. The policy *payout* is not affected by *smoothing* gains and losses on *payouts* made in the *financial years* before it started.

The *smoothing* gains or losses will normally be expressed as a percentage of the *asset shares* of the relevant policies remaining and taken into account when setting final bonus rates and *payouts* for *maturities*, deaths, and *withdrawals*. The adjustment will be made regardless of the application of any other *smoothing of payouts* at the time of *maturity*, death or *withdrawal*.

The adjustments may be calculated separately for *classes of with-profits* business where we expect significant differences in *smoothing* gains or losses, for example as a result of being backed by a different asset mix.

The extent to which *smoothing of payouts* applies may be restricted so as to limit the expected impact on *payouts* for the remaining policyholders. *Smoothing* will normally be reduced whenever it is expected to result in:

- gains or losses on *payouts* in any rolling 12 month period of more than 1% of the *asset shares* of relevant policies remaining at the end of the year; or
- total accumulated gains or losses on past *payouts* of more than 3% of the *asset shares* of relevant policies remaining at the end of the year. There will normally be no *smoothing of investment returns* and *payouts* if the total accumulated *smoothing* gains or losses on past *payouts* amount to 5% or more of the *asset shares* of the relevant remaining policies, unless future *smoothing* gains or losses are expected to reduce that figure.

Despite these restrictions on the *smoothing of payouts*, actual *smoothing* gains or losses may fall outside these limits (e.g. in circumstances such as rapidly falling or increasing *investment returns*). In these circumstances, and if deemed necessary in the interests of fairness, *Phoenix* would normally address these gains or losses through the *smoothing* for future *payouts* in the same way as described above.

Currently for with-profits contracts in Ireland and German ex-HSL contracts *smoothing* gains and losses are not reapplied as adjustments to the payouts (or bonus rates) of remaining contracts.

For other with-profits contracts in Germany and Austria, prior to November 2013 *smoothing* gains and losses were not reapplied as adjustments to the payouts (or bonus rates) of remaining German and Austrian contracts.

### **Treatment of smoothing profits and losses – Unitised Sub-type III with-profits policies**

For Unitised Sub-type III policies, the objective that *smoothing* should be neutral over time to with-profits policyholders as a whole is achieved by automatically allocating to the *asset shares* of the remaining Unitised Sub-type III policies the gains and losses that arise as a result of the application of *smoothing* to *payouts*. The policy *payout* is not affected by *smoothing* gains or losses on *payouts* made before it started. At the close of each day, any gains or losses arising from the application of *smoothing* to *payouts* that day are normally spread across the *asset shares* of the remaining policies.

The extent to which *smoothing of payouts* applies may be restricted so as to limit the expected impact on *payouts* for the remaining policyholders, in a similar way to that described above. [See Treatment of *smoothing* profits and losses - Policies other than Unitised Sub-type III.]

## 3.4 Setting Payouts - Investigations

Our aim is to treat with-profits policyholders fairly. *Asset shares* are used as a tool to help calculate fair *payouts*. The parameters used in the calculation of *asset shares* depend on the type of claim being considered and the product type. This section describes the investigations that *Phoenix* carries out to determine the appropriate *asset shares* for its *with-profits policies*.

This section does not apply to With Profits Pension Annuities (see Section 3.5).

### 3.4.1 Current Practices

As discussed in Section 3.3:

- for Conventional and Unitised Sub-type I *with-profits policies*, we carry out investigations at least annually in order to determine *asset shares* for *representative* policies and set payout calculation factors; and,
- for Unitised Sub-type II and Unitised Sub-type III *with-profits policies*, we calculate unit prices and *asset shares* daily in order to determine *payouts*.

#### 3.4.1.1 Documentation and Change Control

For all the various policy types we document and retain details of the methods, parameters and *smoothing* mechanisms used.

#### 3.4.1.2 Approximations

In calculating *asset shares*, we aim to use our best estimates of the relevant parameters as they affect the relevant *representative* policies we have selected to use. In calculating some parameters, for example, per policy expense allowances, there is an element of averaging across *with-profits policies*.

Also, most *asset share* calculations do not use daily *investment return* data and so involve an element of approximation.

In normal conditions, these approximations are not likely to lead to significant over- or under-statement of *asset shares*. Nevertheless, as part of the periodic reviews of our *asset share* methodology, we review the approach we take and refine it when we consider it appropriate.

Where final bonus rates are set by reference to *asset shares* of *representative* policies, we may allow for estimated future changes in the relevant *asset shares* during the period for which we expect the rates to apply.

For Unitised Sub-type I pension policies, the *asset share* calculations use *representative* policies which incorporate an adjustment to compensate for the lag in the period over which the *investment returns* are calculated compared with the period to which they are related in the final bonus rates. The adjustment is calculated at an aggregate level and applied uniformly to *asset shares* calculations for relevant *representative* policies.

Calculations for Unitised Sub-type II policies are carried out daily. For UK and Ireland these are on the basis of estimated *investment returns* based on appropriate index returns, with subsequent adjustments made from time to time to reflect differences between the estimates and the investment performance actually achieved. Policies in Germany and Austria use actual investment returns.

For minor *classes of with-profits policies* (constituting less than 10% of the with-profits liabilities), where it is considered appropriate and cost effective, *Phoenix* may, at the *Board's* discretion, use *asset shares* for similar types of *with-profits policies* or some equivalent



measure in the setting of *payouts* and final bonus rates. All references to *asset shares* in *this PPFM* include these alternatives. These minor *classes of with-profits policies* currently include the following Conventional with-profits product types:

- Conventional Additional Voluntary Contribution Schemes;
- Endowment Assurance Master Contract;
- Establishment;
- Executive Pension Plan Pure Endowment;
- Ex-HSL contracts (Germany);
- Group Money Purchase Pure Endowment VC Scheme;
- Low Cost Plan;
- Minimum Cost Plan;
- Standing Loan Plan;
- Stanplan M and own trust equivalent; and
- Stanplan M2 and own trust equivalent;
- Whole of Life Assurance;

and the following Unitised with-profits product types:

- Peppercorn Investment Bond (PIB); and
- Variable Protection Plan.

### 3.4.1.3 Conventional Life and Pension Policies

This section describes how some of the parameters required to calculate *asset shares*, and most discretionary adjustments, are determined for Conventional *with-profits policies*.

For Conventional pension policies the payout calculation factors are calculated separately for single premium and regular premium policies. Therefore, when determining payout calculation factors for these policies we use *representative policy asset shares* corresponding to single premium policies for the former and *representative policy asset shares* corresponding to regular premium policies for the latter.

Most Conventional life policies are regular premium policies and so when determining payout calculation factors for these policies, we use *representative policy asset shares* corresponding to regular premium policies. There is a small group of single premium Conventional life policies, for which separate payout calculation factors are calculated, using *representative policy asset shares* corresponding to single premium policies.

#### Parameters and Assumptions

Most relevant *representative policy* details (e.g. premiums, sums assured) are obtained from the relevant historic records. Where the records are not adequate, appropriate estimates are made, consistent with the available data.

#### Expenses and Charges

The treatment of expenses in the calculation of Conventional *with-profits policy asset shares* depends on whether the *asset share* is calculated on an expenses basis or a charges basis. Broadly speaking Conventional *with-profits policies* sold since 1 January 1995 are on a charges basis and those sold earlier are on an expenses basis.

For those policies where the *asset share* is calculated on a charges basis, the deductions made for expenses from the *asset share* are set at a level consistent with the basis used to produce illustrative *maturity* values when the policy was taken out.

When attributing expenses to *representative Conventional with-profits policies* where the *asset share* is on an expenses basis, our aim is to apply to each *class* of such policies, over time and so far as is practicable:

- pre-demutualisation the appropriate share of the actual expenses incurred by The Standard Life Assurance Company; and
- post-demutualisation, the appropriate share of the expenses charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*.

Data comes from various sources – for example, previous internal expense analyses or appropriate estimates consistent with available data.

For ex-HSL business there are only premium based charges. No deductions are taken from *asset shares*.

### **Deductions for mortality and other risk benefits**

Where life cover is provided the *asset share* of the *representative* policy allows for a mortality deduction. This deduction is based on mortality rates derived from standard mortality tables, with different adjustments for Conventional life and pensions policies. No allowance is made for any sickness or other risk benefit provided: these are taken into account in setting the premium or sum assured for a policy.

*Phoenix* monitors how the actual experience compares with that implied by the deductions. Any variation between the actual experience and the corresponding deductions made for mortality and other risk benefits when calculating *asset shares* may be directly attributed to, or met by, the *asset shares* of *with-profits policies* through *experience adjustments*.

### **Investment Return**

The *investment return* applied to *asset shares* is consistent with the *investment return* earned on the assets backing the *asset shares*. The relevant mix of assets may be different for different *classes* of *Conventional with-profits policies*. The *investment returns* used in *asset share* calculations are, where relevant, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees

### **Tax**

For the life business an appropriate allowance for tax is included. Tax relief is applied to the expenses and investment income is taxed at the appropriate policyholder rate (or rates) and an allowance is also made for the appropriate share of policyholder tax on realised capital gains each year.

We make a further allowance in respect of policyholder tax on unrealised capital gains. This further allowance (which could be either positive or negative, depending on asset values) is to make appropriate discounted allowance for our best estimate of expected future rates of realisation of assets and is reviewed regularly.

In accordance with the *Scheme*, tax is charged to the *Heritage With-Profits Fund* as though it were a stand alone mutual assurance company. Any variation between the actual tax charged to the Fund and the corresponding deductions made for tax when calculating *asset shares* may be directly attributed to, or met by, the *asset shares* of *with-profits policies* through *experience adjustments*.

### **Contribution to capital**

A contribution to the *Inherited Estate* is made by *Conventional with-profits policies* where *asset shares* are calculated on an *expense basis*, through a deduction in the *asset share* calculation fixed at 0.5% a year.

### **Allowance for the Cost of Guarantees**

When calculating *asset shares*, a deduction is made for the assessed cost to the *Heritage With-Profits Fund* (on assumptions we consider appropriate) of providing guarantees on *with-profits policies* in the Fund. The deduction varies between policies, broadly reflecting the types of guarantee provided. When we issue illustrations of future policy benefits, we make allowance for the deductions that may be taken.

The assessed cost of the guarantees that are provided depends on investment and economic conditions and on assumptions we make about how these might change in the future. If necessary we will therefore vary the level of deductions described above in the light of changes in conditions. (For more information see Section 3.8.)

For ex-HSL business there is no such deduction taken from *asset shares*.

### **Smoothing**

Having calculated the relevant *representative policy asset shares* without allowing for the effect of any *smoothing*, we then apply whatever *smoothing* has been approved by the *Board* (see Section 3.3). The resulting values, increased where appropriate to reflect any distribution of *Inherited Estate*, are used to produce payout calculation factors as described in Section 3.3. Any final bonus will therefore also reflect any distribution of any *Inherited Estate*. German ex-HSL policies are not eligible for any distribution from the *Inherited Estate*.

### **Experience Adjustments**

*Phoenix* will normally adjust *asset shares* to reflect variations between the deductions made for tax, mortality or other risk benefits and the actual experience by changing historical parameters used in *asset share* calculations or applying *experience adjustments* (see Section 3.3.2.1). Different *classes of with-profits policies* may receive a different adjustment (positive or negative).

### **Withdrawals**

We calculate *asset shares* for *representative* withdrawing policies, using appropriate parameters derived in a similar way to those for maturing policies. Allowance is then made for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided should apply to *withdrawals*. The resulting values, increased where appropriate to reflect any distribution of *Inherited Estate*, are used to set payout calculation factors as described in Section 3.3. German ex-HSL policies are not eligible for any distribution from the *Inherited Estate*.

As stated in Section 3.3.2.1, the effect of any *smoothing* on *withdrawals* could be different to that on *maturity* claims. Other discretionary adjustments might also be different. For example, high levels of *withdrawals* for policies where initial expenses have not yet been fully recouped through the applicable charging basis could lead to losses which could be allocated across such withdrawing *with-profits policies*. Similarly, in the calculation of *withdrawal payouts* we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had the policy remained invested in with-profits. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

#### **3.4.1.4 Unitised Sub-type I - Life and Pension Policies**

This section describes how some of the parameters required to calculate *asset shares*, and most discretionary adjustments, are determined for Unitised Sub-type I *with-profits policies*. The calculation of the *asset share* is very similar to that described for the Conventional with-profits business. However, not all the parameters are determined in exactly the same way.

For Unitised Sub-type I pension policies the payout calculation factors currently vary according to the *bonus year* in which the units were allocated (see Section 3.3.2.3). Therefore, when determining payout calculation factors for these policies, we primarily focus on *representative policy asset shares* corresponding to single premium policies.

For Unitised Sub-type I life policies the payout calculation factors vary according to the number of years for which the policy has remained invested in with-profits. When determining payout calculation factors for these policies, we use *representative policy asset shares* for regular premium policies as these reflect the majority of the Unitised Sub-type I life policies.

### **Parameters and Assumptions**

Most relevant *representative* policy details (e.g. premiums, sums assured) are obtained from the relevant historic records. Where the records are not adequate, appropriate estimates are made, consistent with the available data.

### **Expenses and Charges**

The allowance for expenses depends on the type of product being modelled and, for UK life policies, when it was started.

For Unitised Sub-type I life policies the allowance for expenses or charges is determined in the same way as for Conventional life business including due allowance for tax relief (see Section 3.4.1.3).

For Unitised Sub-type I pension policies we use a charges basis consistent with that for an equivalent investment-linked policy. The charges basis reflects the revised charging structure (referred to as “re-pricing”) introduced to policies in 2001/2002 (the date varied according to policy type). For policies sold before then an adjustment is made to the charges basis if necessary to compensate for a reduction in value that could otherwise result from the re-pricing.

For Unitised Sub-type I policies in Ireland, an expenses basis *asset share* is used when calculating *asset shares*.

### **Deductions for mortality and other risk benefits**

If life cover, or another risk benefit, is provided for Unitised Sub-type I policies then the costs are met either by cancellation of units or by payment of an explicit premium.

When determining payout calculation factors we maintain consistency between the unit value and the asset share and the factors are appropriate whether or not there are risk benefits and irrespective of the method used to meet the costs of any risk benefits.

- For life policies we allow for a mortality deduction in respect of life cover in the calculation of *asset shares* for the *representative* policies, and a corresponding reduction in the number of with-profits units. This deduction is at the same rate as that applicable to corresponding investment-linked business and constitutes one component of the *shareholder cashflows*.
- For pension policies there is a very wide range of levels of mortality and other risk benefits that might apply and many policies have no such benefits. Therefore, when determining payout calculation factors we use *representative* policies that have no mortality or other risk benefits and so there is no need for the *asset share* calculations to allow for any deductions for such benefits.

### **Investment Return**

Except for the Pension Inflation Plus Fund relevant *representative* policies, the *investment return* applied to *asset shares* is consistent with the *investment return* earned on the assets backing the *asset shares*. The relevant mix of assets is different for different *sub-funds* of the with-profits business of this Unitised Sub-type. For Pension Inflation Plus Fund relevant

*representative* policies, the *investment return* is based on a portfolio of UK index-linked bonds and money market instruments including cash deposits. The *investment returns* used in *asset share* calculations are, where relevant, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees.

## **Tax**

For the life business, allowance is made for policyholder tax on income and capital gains (both realised and unrealised) and for tax relief on expenses in the same way as for the Conventional with-profits business (see Section 3.4.1.3).

Tax will be charged to the *Heritage With-Profits Fund* as though it were a stand alone mutual assurance company. Any variation between the actual tax charged to the Fund and the corresponding deductions made for tax when calculating *asset shares* may be directly attributed to, or met by, the *asset shares* of *with-profits policies* through *experience adjustments*.

## **Contribution to capital**

A contribution to the *Inherited Estate* is made by Unitised Sub-type I *with-profits policies* where *asset shares* are calculated on an *expense basis*, through a deduction in the *asset share* calculation fixed at 0.5% a year.

## **Allowance for the Cost of Guarantees**

When calculating *asset shares*, a deduction is made for the assessed cost to the *Heritage With-Profits Fund* (on assumptions we consider appropriate) of providing guarantees on *with-profits policies* in the Fund. The deduction varies between policies and *sub-funds*, broadly reflecting the types of guarantee provided. When we issue illustrations of future policy benefits, we make allowance for the deductions that may be taken.

The assessed cost of the guarantees that are provided depends on investment and economic conditions and on assumptions we make about how these might change in the future. If necessary we will therefore vary the level of deductions described above in the light of changes in conditions. (For more information see Section 3.8.)

## **Smoothing**

Having calculated the relevant *representative* policy *asset shares* without allowing for the effect of any *smoothing*, we then apply whatever *smoothing* has been approved by the *Board* (see Section 3.3). The resulting values, increased where appropriate to reflect any distribution of *Inherited Estate*, are used to produce payout calculation factors as described in Section 3.3. Any final bonus or Unit Price Adjustment will therefore also reflect any distribution of any *Inherited Estate*.

## **Experience Adjustment**

*Phoenix* will normally adjust *asset shares* to reflect variations between the deductions made for tax and the actual experience by changing historical parameters used in *asset share* calculations or applying *experience adjustments* (see Section 3.3.2.1). Different *classes* of *with-profits policies* may receive a different adjustment (positive or negative).

## **Withdrawals**

We calculate *asset shares* for *representative* withdrawing policies, using appropriate parameters derived in a similar way to those for maturing policies. Allowance is then made for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided should apply to *withdrawals*. The resulting values, increased where appropriate to reflect any distribution of *Inherited Estate*, are used to set payout calculation factors as described in Section 3.3.

As stated in Section 3.3.2.1, the effect of any *smoothing* on *withdrawals* could be different to that on *maturity* claims. Other discretionary adjustments might also be different. For example, high levels of *withdrawals* for policies where initial expenses have not yet been fully recouped through the applicable charging basis could lead to losses which could be allocated across such withdrawing *with-profits policies*. Similarly, in the calculation of *withdrawal payouts* we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

#### 3.4.1.5 Unitised Sub-type II Policies

This section describes how some of the parameters required to calculate *asset shares*, and most discretionary adjustments, are determined for Unitised Sub-type II *with-profits policies*. For these policies, *payouts* are determined from individually calculated *asset shares*.

The parameters used in these *asset share* calculations are as follows:

##### **Expenses and Charges**

The *asset shares* for Unitised Sub-type II policies are all calculated on a charges basis. The charges comprise an appropriate daily deduction and any explicit charges specified in the policy's contractual terms and conditions. These daily deductions will be set at a level no greater than the fund management charge for an equivalent investment-linked policy. We regularly review the basis upon which we set appropriate daily deductions and the basis on which we do so may change from time to time. Any changes to deductions for German and Austrian policies must comply with the relevant law.

##### **Deductions for mortality and other risk benefits**

The *asset share* for Homeplan policies allows for a mortality deduction, and there is a corresponding reduction in the number of with-profits units. This deduction is at the same rate as applicable to an equivalent investment-linked policy and contributes to *shareholder cashflows*. Other risk benefits, such as critical illness benefits, for Homeplan policies are treated similarly.

For other UK or Irish Sub-type II policies, deductions for risk benefits are taken at the same rate as applicable to an equivalent investment-linked policy and contribute to *shareholder cashflows*.

The *asset share* for German and Austrian Sub-type II policies allows for a mortality deduction in the same way as for Homeplan policies but the deductions are retained within *the Fund*. Other risk benefits, such as critical illness benefits, are treated similarly.

##### **Investment Return**

For Unitised Sub-type II policies, we estimate the daily *investment return* on the assets backing the *asset shares*. The relevant mix of assets could be different for different *classes* of policy and/or *sub-funds*. The changes in value of the relevant assets are initially assumed to be matched by the changes in appropriate published indices and so from these the daily return is estimated. Adjustments are then made to *asset shares* from time to time to reflect differences between the estimated *investment return* and the *investment return* actually achieved on the assets backing the *asset shares*, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees.

For Unitised Sub-type II policies in Germany and Austria, the *asset shares* are based directly on the investment returns on the assets backing those asset shares, in the same way as described below in *this PPFM* for Unitised Sub-type III policies. We do not use estimated returns.

### **Tax**

Allowance is made for policyholder tax on income and capital gains (both realised and unrealised) and for tax relief on expenses in a similar way as for the Conventional with-profits life business (see Section 3.4.1.3).

Tax will be charged to the *Heritage With-Profits Fund* as though it were a stand alone mutual assurance company. Any variation between the actual experience and the corresponding deductions made for tax when calculating *asset shares* may be directly attributed to, or met by, the *asset shares* of UK and Irish *with-profits policies* through *experience adjustments*. Such experience adjustments do not apply to German and Austrian business.

### **Allowance for the Cost of Guarantees**

When calculating *asset shares*, a deduction is made for the assessed cost to the *Heritage With-Profits Fund* (on assumptions we consider appropriate) of providing guarantees on *with-profits policies* in the Fund. The deduction varies between policies and *sub-funds*, broadly reflecting the types of guarantee provided. When we issue illustrations of future policy benefits, we make allowance for the deductions that may be taken.

The assessed cost of the guarantees that are provided depends on investment and economic conditions and on assumptions we make about how these might change in the future. If necessary we will therefore vary the level of deductions described above in the light of changes in conditions. (For more information see Section 3.8.)

### **Experience Adjustments**

*Phoenix* will normally adjust UK and Irish *asset shares* to reflect variations between the deductions made for tax and actual experience by changing historical parameters used in *asset share* calculations or applying experience adjustments (see Section 3.3.2.1). Different *classes of with-profits policies* may receive a different adjustment (positive or negative). Such experience adjustments do not apply to German and Austrian business.

### **Smoothing**

Having calculated the policy's *asset share* without allowing for the effect of any *smoothing*, we then apply whatever *smoothing* has been approved by the *Board* (see Section 3.3). Any final bonus or Unit Price Adjustment will also reflect any distribution of any *Inherited Estate*.

### **Withdrawals**

We calculate *asset shares* for withdrawing policies using appropriate parameters derived in a similar way to those for maturing policies. Allowance is then made for the effect of any *smoothing* and any other discretionary adjustments the *Board* has decided should apply to *withdrawals* and appropriate *payout* levels set.

As stated in Section 3.3.2.1, the effect of any *smoothing* on *withdrawals* could be different from that on *maturity* claims. Other discretionary adjustments might also be different. For example, high levels of *withdrawals* for policies where initial expenses have not yet been fully recouped through the applicable charging basis could lead to losses which could be allocated across such withdrawing with-profit policies. Similarly, in the calculation of *withdrawal payouts* for UK and Irish policies we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

Should our *Practices* in this area conflict with German or Austrian law on surrender values then, as for all business, the relevant law shall prevail. This may restrict the adjustments that can be made.

#### 3.4.1.6 Unitised Sub-type III Policies

This section describes how some of the parameters required to calculate *asset shares*, and most discretionary adjustments, are determined for Unitised Sub-type III *with-profits policies*. As for Unitised Sub-type II policies, *payouts* for Unitised Sub-type III policies are determined from individually calculated *asset shares*.

##### Investment Return

The investments backing this with-profits business (UK Stakeholder, German and Austrian Suxcess business) are identified separately for the UK and for Germany and Austria from the rest of the investments attributable to with-profits business in the *Heritage With-Profits Fund*. Since these assets are specifically identified, the *investment return* is obtained from the investment income from, and change in the value of, these assets, and is included daily in the unit prices for these policies. The *investment returns* used are net of any investment management expenses that are deducted directly from funds under management.

German and Austrian Suxcess business differs from UK Stakeholder business in that it does not share in the performance of the *Heritage With-Profits Fund* and is therefore excluded from business risk.

##### Expenses and Charges

The *asset shares* of Unitised Sub-type III policies are all calculated on a charges basis. The only charge is the current explicit fund management charge. However, this charge has a maximum limit in the UK. Any changes to charges for German and Austrian Suxcess policies must comply with the relevant law.

##### Deductions for mortality and other risk benefits

The *asset share* for German and Austrian Suxcess policies allows for a mortality deduction, and there is a corresponding reduction in the number of with-profits units. Other risk benefits, such as critical illness benefits, are treated similarly.

##### Allowance for the Cost of Guarantees

The allowance for the cost of guarantees for these policies is currently zero, reflecting the fact that these policies currently do not include *investment return* guarantees.

##### Smoothing

As stated in Section 3.3.2.7, for Unitised Sub-type III *sub-funds*, at the close of each day, any gains or losses arising from *smoothing on payouts* from the *sub-fund* that day are normally spread across the *asset shares* of remaining policies.

Having calculated the policy's *asset share*, we then apply whatever further *smoothing* has been approved by the *Board* (see Section 3.3). The policy *payout* will also reflect any distribution of any *Inherited Estate* for *eligible policies*. German and Austrian Suxcess policies are not eligible for any distribution from the *Inherited Estate*.



### 3.4.1.7 Withdrawal policy

The *Board* has discretion over the amount to deduct when setting *payouts* for *withdrawals*, subject to the constraint that we will not deduct more than is necessary to protect the interests of remaining with-profits policyholders. Such deductions shall be retained in the *Heritage With-Profits Fund*.

We are likely to make this type of deduction where we deem the level of surrenders to be high or to be selective in nature, or where this is otherwise necessary, in the opinion of the *Board*, to protect the interests of the remaining with-profits policyholders. For example, higher than normal levels of *withdrawals* for policies where initial expenses have not yet been fully recouped through the applicable charging basis could lead to losses that may be allocated across such withdrawing policies. Another example in the calculation of *withdrawal payouts* for UK and Irish policies is that we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

Should our *Practices* in this area conflict with German or Austrian law on surrender values then, as for all business, the relevant law shall prevail. This may restrict the adjustments that can be made.

## 3.5 With Profits Pension Annuity: Declared Rate of Return

### 3.5.1 Current Practices

This section only applies to with-profits pension annuity contracts in the UK and Ireland and does not apply to similar German and Austrian contracts (Freelax Sofort, please see Appendix C.)

For the With Profits Pension Annuity in the UK and Ireland a *Declared Rate of Return* is applied to the then current annuity payment, normally on the anniversary of the first annuity payment. In accordance with the policy's contractual terms and conditions, any resulting change in annuity payment will take into account the "Anticipated Bonus Rate" selected by the annuitant.

The *Declared Rate of Return* reflects the *investment return*, over the relevant period, of the relevant assets, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees, after allowing for:

- expenses and charges;
- any deductions the *Board* considers appropriate to make in respect of the assessed cost of guarantees provided under with-profits business (see Section 3.8);
- a fixed contribution of 0.5% to the *Heritage With-Profits Fund's* capital;
- any *smoothing*; and
- any distribution of any *Inherited Estate*.

*Phoenix* guarantees not to declare a rate of return in any one year of less than negative 10%. The corresponding maximum reduction in pension amount depends on the Anticipated Bonus Rate selected by the annuitant.

Each month we declare rates of return to apply on the anniversary dates of annuities in payment. The annuity payment for a policy normally only changes on the yearly anniversary of the first annuity payment. We retain the right to revise the annuity payment before the next anniversary date if this is necessary to ensure fairness.

*Smoothing* is policy specific and reflects the period the policyholder invests in the fund. Therefore, separate rates (which may or may not be different) are declared at any one time for policies of different durations.

## 3.6 Trustee Investment Plans

### 3.6.1 Current Practices

Trustee Investment Plans (“TIPs”) are investment-only contracts available to occupational pension schemes. That is, *Phoenix* manages the scheme’s investment but does not deal directly with individuals in the scheme.

Because this is an investment-only contract, there is no set term and so maturity dates do not apply. Instead, on each anniversary date, we normally encash those units which were allocated more than 15 years previously. The proceeds of the encashment can then be divested or reinvested under the TIP at the trustees’ request, in whatever with-profits or other investment choices are available for such a reinvestment at that time.

A guarantee may apply to certain units when they are encashed. If the guarantee applies, the encashment value of those units is their *unit value* plus any final bonus payable. Final bonus rates are set, using parameters applicable to these plans, in the same way as for Unitised Sub-type I pension policies.

The guarantee applies:

- to the units that we encash at each anniversary date which were allocated more than 15 years previously; and
- to units that are encashed in any plan year, up to a limit of 10% of the number of units which were allocated more than 2 years previously on the first day of that plan year. The first day of a plan year is the anniversary date.

For any other encashment, our current intention is to pay out amounts that are broadly in line with individually calculated *asset shares*, having applied any *smoothing* and any other discretionary adjustments the *Board* has decided are appropriate at the relevant time. In the calculation of encashment values we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits until its 15 year encashment date. As described in Section 3.8, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*. The circumstances in which adjustments to the unit price may be applied are stated in the contractual terms and conditions.

The *asset share* is as defined in Section 3.3.2.1, although no allowance is made for mortality or other risk benefits, since these do not apply. No allowance is required for tax under the current tax regime.

## 3.7 Allocating Expenses and Charges

This section explains how *Phoenix* applies charges and apportions the expenses of writing and administering with-profits business. For details of other deductions or additions taken into account when calculating *payouts* see Sections 3.4, 3.5, 3.8 and 5.2.

### 3.7.1 Principles

**3.7.1.1 *Phoenix* will make deductions from *asset shares* for expenses and charges. *Phoenix* aims to apply to each class of *with-profits policies*, over time and so far as is practical, no more than the appropriate charge or the appropriate share of the expenses incurred by The Standard Life Assurance Company prior to its demutualisation or charged to the *Heritage With-Profits Fund* post demutualisation in accordance with the *Scheme*.**

**3.7.1.2 In accordance with the *Scheme* the only expenses which may be charged to the *Heritage With-Profits Fund* in respect of with-profits business are those which in the reasonable opinion of the *Board* have been incurred or will be incurred in the operation of the *Heritage With-Profits Fund*.**

### 3.7.2 Current Practices

*Phoenix* incurs expenses in connection with the operation of the *Heritage With-Profits Fund*.

The only expenses which may be charged to the *Heritage With-Profits Fund* in respect of with-profits business are those which in the reasonable opinion of the *Board* have been incurred or will be incurred in the operation of the *Heritage With-Profits Fund*. These expenses will either be applied to *with-profits policies* or met by the *Inherited Estate*.

We may charge some *with-profits policies* less than their share of the expenses charged to the *Heritage With-Profits Fund* in accordance with the *Scheme* and pass the remainder of the cost to the *Inherited Estate* in order to maintain fairness, for example, between generations and between classes of policyholders.

Expenses are recovered in the calculation of *asset shares* and *payouts* (see Sections 3.3 and 3.4) through:

- explicit charges (for example, an explicit fund management charge); or
- a deduction from the *investment return* applied to *asset shares*; or
- appropriate deductions for expenses incurred (for example, an allowance for renewal expenses based on the appropriate internal expense analysis figures); or
- a combination of these.

Which of these methods is used depends on the type of product.

For Conventional *with-profits policies* other than ex-HSL business, depending on when they were sold, either explicit charges or appropriate expenses (based on the expenses incurred by The Standard Life Assurance Company prior to its demutualisation or charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*) are allowed for in the calculation of *asset shares*, which are used to determine final bonuses and *payouts*.

For Unitised Sub-type I and Sub-type II *with-profits policies*, explicit charges may or may not apply (as may be stated in the contractual terms and conditions). Either way, the relevant expenses or charges are allowed for in the calculation of *asset shares* (and hence final bonuses and *payouts*).

For current Unitised Sub-type III *with-profits policies*, there is only an explicit fund management charge, which for UK policies has a maximum value. At the *Board's* discretion UK Unitised Sub-type III policies may receive a rebate of some of the fund management charge. These bonuses may take the form of additional units. The *Board* has no discretion to rebate any part of the fund management charge for German and Austrian Suxcess business to reflect participation in any surplus.

Where explicit charges apply, the levels of charge are in accordance with the contractual terms and conditions. In some cases, there may also be reductions to charges that apply for larger fund sizes or other adjustments which aim to ensure that no policyholder is disadvantaged by an historic change in charging structure.

For the With Profits Pension Annuity, expenses are taken into account when setting the initial level of annuity and when calculating the *Declared Rate of Return* (see Section 3.5).

A charge may apply on switches between funds for Unitised policies. Details of the charges are contained within the relevant contractual terms and conditions.

Where a policy includes life cover, or another risk benefit, an appropriate deduction is made for its cost in calculating *payouts*. For some Unitised policies, this is taken as an explicit premium charge rather than as a regular deduction from *asset shares* (see Section 3.4). For these policies, an explicit charge will also apply for any other risk benefit, such as critical illness cover and/or premium protection which is regarded as a separate, non with-profits, benefit.

### **Outsourcing**

*Phoenix* may outsource tasks (either to subsidiaries within the *Phoenix Group* or externally) where we believe that this will improve efficiency or where it fits with the business model of the *Phoenix Group*. Where tasks are outsourced within the *Phoenix Group*, the expenses charged to the *Heritage With-Profits* Fund exclude any profit loading or other margin. The investment of with-profits assets is carried out by external investment managers under instructions from the *Board of Phoenix* in return for a contractual fee.

Where outsourcing is considered appropriate, the arrangements are regularly reviewed by the *Board* (or by managers of *Phoenix* on their behalf). The frequency of such reviews depends on the nature and extent of the services provided. This is irrespective of whether the outsourcing is to a connected or third party.

Termination provisions for outsourcing arrangements also vary by engagement but typically include the right to terminate in the event of material breach of any of the key provisions or failure to meet the agreed service standards.

## 3.8 Deductions for the assessed cost of guarantees

This section explains how *Phoenix* determines the deductions from *asset shares* for the assessed cost to the *Heritage With-Profits Fund* of providing guarantees on *with-profits policies* in the Fund. For details of other deductions or additions taken into account when calculating *payouts* see Sections 3.4, 3.5, 3.7 and 5.2.

### 3.8.1 Principles

**3.8.1.1 *Phoenix* will, in calculating with-profits *asset shares* and determining *Declared Rates of Return*, make fair deductions to reflect its assessment of the cost of guarantees.**

### 3.8.2 Current Practices

#### 3.8.2.1 Business written before demutualisation

The deductions made for the assessed cost of guarantees depend on the type of with-profits contract and, if unitised with-profits, the unitised *sub-fund* in which the policy is invested.

As at 31 December 2005, we set a level of regular (normal) deduction per annum for the assessed cost of guarantees for each *class* of with-profits business. The levels were changed on 1 January 2007 for Irish business and on 1 July 2012 for German and Austrian business with a guaranteed return on premiums of 4.875%, 2.875%, or 2.375% (see Appendix C).

For example, in the UK these are as follows:

- 0.00% for With Profits Pension Annuity;
- 0.05% for With Profits Bond;
- 0.15% for unitised pension business with a 0% guaranteed minimum unit price growth rate, Versatile Investment Plans taken out after 27 August 2001 and Homeplan policies;
- 0.50% for conventional business; and
- 0.75% for unitised business with a 3% or 4% guaranteed minimum unit price growth rate (including Versatile Investment Plans taken out before 28 August 2001).

If we believe it would be fairer to particular groups of policies, we may introduce or change *classes* of with-profits business for the purpose of setting deductions for the assessed cost of guarantees. In particular we may introduce new *classes* for with-profits premium increases, including single premiums and transfer values, and switches into with-profits from non with-profits funds. If we do this, references to 31 December 2005 in this section should be taken as references to the date of introduction of the new *class* or *classes*.

A further uniform deduction is determined at least annually to reflect any loss incurred by the Fund in respect of guarantees relative to the position at 31 December 2005. Such uniform deduction is limited to 0.75% per annum, and the sum of the regular deduction and the uniform deduction is limited to 1.00% per annum. In addition, we may choose not to change the level of the uniform deduction if the required amount of the change is less than 0.1% per annum.

If experience subsequently improves, the further uniform deductions will be reduced or may cease. If experience improves sufficiently to extinguish the loss, we will refund the further uniform deductions taken (less increased costs actually incurred) as a one-off enhancement to *asset shares*.

In light of good experience that results in the value of deductions (both actually taken and expected in future) exceeding the cost of incurred and expected guarantees we will reduce pro rata the level of regular (normal) deductions subject to there being sufficient guarantee surplus from business written before demutualisation to allow this.

If experience subsequently deteriorates we will first reintroduce the regular (normal) deductions up to the previous level. If experience continues to deteriorate then we will only introduce further uniform deductions when a loss has been incurred by the Fund relative to the position at 31 December 2005.

We will normally perform this determination once a year, but may do so more frequently, for example following a significant change in asset values or asset volatility.

In the calculation of *withdrawal payouts* for UK and Irish business, we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits. As described above, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

We are likely to adjust *withdrawal payouts* in this way where we deem the level of surrenders to be high or to be selective in nature or where this is otherwise necessary, in the opinion of the *Board*, to protect the interests of the remaining with-profits policyholders.

Should our *Practices* in this area conflict with German or Austrian law then, as for all business, the relevant law shall prevail.

### 3.8.2.2 Business written in, or allocated to, the Heritage With-Profits Fund on or after demutualisation

The deductions are different for with-profits business written after demutualisation. At the time of demutualisation we set the following levels of deduction per annum for the assessed cost of guarantees for each *class* of UK with-profits business:

- 0.10% for With Profits Bond; and
- 0.20% for other unitised business with a 0% guaranteed minimum unit price growth rate.

If we believe it would be fairer to particular groups of policies, we may introduce or change *classes* of with-profits business for the purpose of setting deductions for the assessed cost of guarantees at our discretion. In particular we may introduce further new *classes* for new with-profits business after a particular date, including with-profits premium increases, single premiums and transfer values, and switches into with-profits from non with-profits funds.

We assess the level of deduction at least annually to reflect experience, but may do so more frequently, for example following a significant change in asset values or asset volatility. If experience improves, the level of deduction may reduce. If experience deteriorates, the level of deduction may increase up to a limit of 1.00% per annum. We may choose not to change the level of the deduction if the required amount of the change is less than 0.1% per annum. If experience subsequently improves we may choose to refund the increased deductions taken (less increased costs actually incurred) as a one-off enhancement to *asset shares*.

In the calculation of *withdrawal payouts* for UK and Irish policies we may deduct an amount in respect of future deductions for the assessed cost of guarantees provided under with-profits business. This adjustment would be for deductions that we could have made had that part of the policy remained invested in with-profits. As described above, the level of these deductions can change and so the amount we deduct in the calculation of a *withdrawal* payment may reflect potential increases above the level that applies to that *class* of business at the date of *withdrawal*.

We are likely to adjust *withdrawal payouts* in this way where we deem the level of surrenders to be high or to be selective in nature or where this is otherwise necessary, in the opinion of the *Board*, to protect the interests of the remaining with-profits policyholders.

### 3.8.2.3 Factors that may affect the size of guarantee deductions and any refunds

Guarantee deductions may be affected by a number of factors. These include the returns on the assets backing the *asset shares* and guarantee liabilities of *with-profits policies*, the size of the guarantees relative to *asset shares* for individual policies and for groups of policies, future increases in the amounts guaranteed, and the length of time over which future deductions are going to be made.

When we review the size of the guarantee deductions we take into account the combined past experience of all the with-profits business written in the UK, Ireland, Germany and Austria and our assessment of the future experience of that business, including withdrawal rates and any regular bonuses that we might add. A change in actual or assumed experience that increases the assessed cost of guarantees for one type of with-profits business or the business written in one country can therefore result in a change in the guarantee deductions for all types of with-profits business written in the UK, Ireland, Germany and Austria.



## 4. How the With-Profits Assets are Invested

Section 3.3.2.1 explains that the most important influence on *asset shares* is usually the *investment return* earned on the assets held to back them. This section describes the approach *Phoenix* follows in seeking to provide growth over the long term for *with-profits policies*, while continuing to maintain an appropriate level of financial strength so we can meet all contractual obligations to our with-profits policyholders. It concentrates on how we invest the assets backing *with-profits policy asset shares* but also includes details on how some of the other assets (within what is referred to as the “*with-profits assets*”) are invested.

Some of these other assets are set aside as reserves for particular risks and contingencies. The remaining other assets form part of the *Inherited Estate* (see Section 5.2).

### 4.1.1 Principles

**4.1.1.1** Within certain constraints determined and reviewed from time to time by the *Board*, *Phoenix* may invest in assets where the future return is uncertain (i.e. that are subject to market risk and other risks), where it believes this is appropriate in terms of the returns likely to be achieved. *Phoenix* usually invests its *with-profits assets* in a wide range of asset classes, usually including equities, property, bonds and cash deposits. This may be achieved through holding appropriate derivative contracts as well as the underlying assets themselves.

**4.1.1.2** The investment policy for the *Heritage With-Profits Fund* shall be determined subject to such constraints as may be necessary to ensure that the financial position of the *Heritage With-Profits Fund* is adequate in the opinion of the *Board*.

**4.1.1.3** The investment policy for the *Heritage With-Profits Fund* shall have regard to the nature of the liabilities of the *Heritage With-Profits Fund* including guarantees on *with-profits policies* and, in particular, (i) seek to match the liabilities in respect of non with-profits policies allocated to the *Heritage With-Profits Fund* with assets of an appropriate nature and term and (ii) have regard to the reasonable expectations of the holders of *with-profits policies* in the *Heritage With-Profits Fund* and the duty to treat them fairly.

**4.1.1.4** The investment policy and *Practices* are reviewed regularly by the *Board* to ensure their continued suitability in terms of liquidity, risk (including counterparty risk) and likely return, given the obligations and financial position of the *Heritage With-Profits Fund*.

**4.1.1.5** *Phoenix* will not back *asset shares* of policies in the *Heritage With-Profits Fund* with assets that are, because of their importance to the *Phoenix group*, not normally traded.

**4.1.1.6** The *investment return* attributed to the *asset shares* of a particular group of *with-profits policies* will reflect the net investment returns on the mix of the assets notionally backing that group of business.

**4.1.1.7** In determining from time to time how the assets of the *Heritage With-Profits Fund* shall be invested, *Phoenix* shall use all reasonable endeavours to ensure that the *Heritage With-Profits Fund* is treated fairly compared with its other funds.

**4.1.1.8** Subject to the above *Principles*, we will seek to optimise the *investment return* on assets backing *with-profits policies*.

### 4.1.2 Current Practices

#### 4.1.2.1 Investment Strategy Overview

The *Heritage With-Profits Fund*'s with-profits assets are invested in a wide range of assets, including domestic and overseas equities, property holdings, fixed interest stocks and cash

deposits. These assets may be either actively or passively managed. As part of the exposure to such asset classes, the investment managers may use derivatives as an investment tool, subject to predetermined guidelines. The *Heritage With-Profits Fund's* with-profits assets also include some subsidiary companies and other asset holdings that would not normally be traded. These assets were transferred from the Standard Life Assurance Company into the *Heritage With-Profits Fund* at demutualisation in accordance with the *Scheme*.

As described in this section, in determining our investment strategies we operate within constraints that are reviewed regularly by the *Board*. Within these constraints, we currently follow a number of different investment strategies for the assets backing *with-profits policy asset shares* with the strategy (e.g. mix of assets) applying to a particular *class of policy* and/or *sub-fund* depending on the nature of the relevant liabilities and, in particular, the level of any guarantees provided. Subject to approval by the *Board*, the investment strategy for the assets backing any particular *class of policy* and/or *sub-fund* may be varied from time to time to ensure it remains appropriate. None of the assets backing *with-profits policies' asset shares* are assets that would not normally be traded.

The *Heritage With-Profits Fund* may lend its assets in return for a fee, subject to receipt of appropriate collateral as security. Any stock lending is subject to documented agreements between the fund, its investment managers and its lending agents. An Investment Committee advises the *Board* on the terms under which stock lending takes place and oversees the operation of stock lending arrangements to ensure that they are in accordance with the agreements.

The other assets, including those backing the *Inherited Estate* are invested with the objective of providing stability to the *Heritage With-Profits Fund* and minimising the risk of the *Inherited Estate* failing to fulfil its primary role (as described in Section 5.2.2 below). The *Inherited Estate* is invested in a range of assets. Currently, a significant proportion is invested in cash deposits, fixed interest stocks and derivatives. The *Inherited Estate* investments also include some subsidiary companies that would not normally be traded.

Investment decisions balance risk and expected return. In general, the higher the risk, the higher the expected return. The need to maintain an adequate financial position for the *Heritage With-Profits Fund* constrains the maximum amount of risk that can be taken in search of higher returns.

Within this constraint it can be appropriate to have different risk limits for groups of with-profits assets that back different liabilities.

For example, for policies with guaranteed minimum returns, the more we invest in assets like equities and property, the more capital must be set aside within the *Heritage With-Profits Fund* to cover the possibility of *investment returns* being lower than required to meet the guarantee. The amount of capital required depends on the extent of the guarantees provided.

In the light of the amount of available capital in the *Heritage With-Profits Fund* and the further capital defined in the *Scheme*<sup>4</sup>, it can be necessary as investment market conditions change to adjust the proportions invested in assets like equities and property to ensure that risks remain within acceptable limits. For example, in certain circumstances (e.g. following a sudden or sustained drop in investment values), it may be necessary to reduce significantly the proportion of assets backing *with-profits policy asset shares* invested in equities and property. In assessing the amount of available capital in the *Heritage With-Profits Fund* we take into account all the with-profits business in the *Fund*, whether written in the UK, Ireland, Germany or Austria. As a result, there may be times when investment conditions affecting with-profits business in one country cause us to reduce, for with-profits business in other countries, the proportions invested in assets such as equities and property.

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<sup>4</sup> Details of which are summarised in Appendix D of this document.

In assessing the availability of capital in the *Heritage With-Profits Fund* for the purpose of determining investment strategy, the obligation to transfer future *shareholder cashflows* out of the *Heritage With-Profits Fund* is disregarded. This means that the investment strategy for the *Heritage With-Profits Fund* will take account of the availability of this as capital under stressed conditions.

*Phoenix* in setting investment strategy takes into account a number of factors, including:

- the nature of the liabilities in the *Heritage With-Profits Fund*, including guarantees;
- the need to maintain an adequate financial position for the *Heritage With-Profits Fund*;
- the balance between risk and expected return;
- our approach to *Responsible Investment*;
- the aim to invest in a wide range of asset classes; and
- the need to maintain adequate liquidity.

The investment strategy will normally be set with the objective that the financial position of the *Heritage With-Profits Fund* can withstand a wide range of adverse but reasonably foreseeable circumstances without needing to reduce investment risk.

In normal circumstances we would expect to make any significant changes to the asset mix gradually.

#### 4.1.2.2 Investment Strategy Determination

The investment managers for the *with-profits assets* carry out their duties in line with instructions (including, for example, benchmarks and risk tolerances) approved by the *Board of Phoenix*.

At least once each year, the *Board* approve the constraints to be applied until the next review to the proportion of *with-profits assets* invested in each asset class for each pool of with-profits assets with a separate investment strategy. This process takes into account the level of investment risk being run relative to the capital that is available (disregarding the obligation to make future transfers of *shareholder cashflows*) in the *Heritage With-Profits Fund* together with the further capital defined in the *Scheme*<sup>5</sup>, and the levels of guarantees attaching to policies. Between scheduled reviews investment market conditions are monitored and, if it is considered necessary, the *Board* will carry out a review of these constraints in advance of the next scheduled review.

Once these constraints and any others that are deemed necessary are identified, the next stage is to develop the other elements of the investment strategy, including appropriate benchmarks. The strategy will include contingency plans relating to how the assets will be managed in light of changes in market circumstances.

Relevant committees or individuals review and monitor constraints and contingency plans, as well as benchmarks, associated performance targets and performance against benchmarks, and provide oversight of the investment management process. Senior managers report regularly to the *Board* on the outcome of these investigations.

The *Board* formally approve the constraints and contingency plans, the benchmarks and the associated performance targets.

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<sup>5</sup> Details of which are summarised in Appendix D of this document.

Any changes to the Investment Management Agreement with the investment manager covering the assets under the Fixed Charge can only be made with the agreement of the *SL International* Board. If agreement cannot be reached the reinsurance agreement will terminate.

While the investment managers have to stay close to the approved benchmarks, the objective is to outperform them by exercising discretion within specified limits (see Section 4.1.2.3).

*Phoenix* uses a number of different investment managers for the *with-profits assets* and will replace underperforming managers when this is considered to be in the best interest of with-profits policyholders.

#### 4.1.2.3 Allowable Assets

Subject to the overriding constraints described in the Principles, investment managers are allowed freedom to invest in any financial instrument as long as it meets predefined minimum criteria. For example, the asset must be capable of being priced and administered and must satisfy the requirements of the Risk Policies and the appropriate internal fund specifications (documents setting out how the funds should be managed).

Risk Policies are established for each of credit risk, market risk, liquidity and funding, insurance risk, operational risk and sustainability. Together these policies along with associated governance documentation ensure, so far as is reasonable, that the risks taken in meeting the *Heritage With-Profits Fund's* financial and regulatory objectives are identified and managed in a sound and prudent manner.

It is an overriding prudential requirement that *Phoenix's* assets in the *Heritage With-Profits Fund* are of sufficient quality and are sufficiently well diversified geographically, across industries and across individual counterparties and groups of related counterparties, to constitute appropriate backing for the relevant liabilities. Investment transactions must also comply with all applicable legislation and regulation.

The purpose of the market risk constraints (see list below) is to set a framework within which this overriding requirement must be satisfied, without impairing unnecessarily the ability of the investment managers to invest for return. It is the responsibility of all investment staff to ensure that any overriding requirements are satisfied notwithstanding this framework. Consistent constraints are required to be followed in the investment of other, smaller, portfolios of assets backing non with-profits and *with-profits policies*.

The limits on the amount of investment in any particular type of asset and the credit and liquidity standards imposed are detailed in the internal Risk Policies and associated governance documentation. These restrictions may vary from time to time, but are designed to ensure that adequate levels of diversification and liquidity are maintained. The restrictions in respect of the *with-profits assets* are agreed and reviewed regularly by the *Board*.

Examples of the types of market risk constraints include limits on:

- overall currency exposure;
- exposure to individual companies or real estate investments;
- exposure to investment market sectors;
- exposure to corporate bonds of different credit ratings; and
- exposure to sectors or companies that do not align with our approach to *Responsible Investment*, for example tobacco.

In addition to these asset class specific restrictions, there may be limitations on the acceptable aggregation of exposure to any single entity.

Exposure limits are set and reviewed in accordance with the Risk Policies and associated governance documentation. Any breach of these exposure limits is reported to the relevant committee or person.

The use of new types of investment (such as new derivative structures), or investments whose nature has changed, is monitored to ensure that they meet the minimum criteria and are appropriate.

Derivatives may be employed only:

- to meet contractual obligations of *Phoenix*; or
- if they are an efficient means to reduce either risk or cost; or
- as a means of generating additional capital or income if this can be achieved with an acceptably low level of risk.

Guidelines relating to the use of derivatives are approved at least once a year by the *Board* and are currently set out in the Risk Policies and associated governance documentation.

In employing derivatives, we aim to always have sufficient cash equivalents or underlying assets to cover any potential obligation or exercise right. Derivative transactions may be undertaken for the purpose of efficient portfolio management only if the economic impact of these trades would otherwise have been permitted as a single direct transaction or as a series of direct transactions.

Investment Guideline documents describe further constraints such as the maximum acceptable tracking error (from the benchmarks set) that individual portfolio managers can run. Compliance with both the Risk Policies and the Investment Guideline documents is regularly monitored. Any breach of Risk Policies or Investment Guidelines is reported to the relevant committee or person.

Credit risk in respect of fixed interest stocks is assessed by reference to the counterparties' credit ratings with Moody's, Standard & Poor's or other equivalent measure. Credit risk in respect of deposit investments is assessed using a scoring methodology.

Credit limits are monitored regularly by dedicated analysts. Any breaches of the credit limits are reported to the relevant committee or person, who ensures that an appropriate summary is given to the relevant senior manager in *Phoenix*.

## 5. How Business Risk is Managed

Section 4 describes how *Phoenix* manages the risks associated with investing in assets where the future returns are uncertain (i.e. subject to market and other risks), with the aim of providing growth over the long term for *with-profits policies*, while continuing to maintain an appropriate level of financial strength so we can meet all contractual obligations to our with-profits policyholders, and the processes in place to control the amount of risk taken.

Within limitations set out in the *Scheme*, *Phoenix* may accept some business risks, for example by writing additional business within the *Heritage With-Profits Fund*, if the *Board* consider that such business risk will, over time, provide benefits to its with-profits policyholders. These risks are usually pooled across the *Heritage With-Profits Fund* and may give rise to profits or losses.

Section 5.1 describes how we control and review the business risks in the *Heritage With-Profits Fund*. Section 5.2 describes how *Phoenix* uses its *Inherited Estate* to support with-profits business in the *Heritage With-Profits Fund* in different ways. Then Section 5.3 discusses how *Phoenix* manages its levels of additional business. Section 5.4 describes our approach to managing the interests of with-profits policyholders in the *Heritage With-Profits Fund* and the interests of shareholders.

### 5.1 Business Risks and Rewards

This section describes how *Phoenix* manages the business activities undertaken in the *Heritage With-Profits Fund* and the risks arising from them that are borne by with-profits policyholders.

#### 5.1.1 Principles

**5.1.1.1 *Phoenix* will undertake business risk on behalf of with-profits policyholders in the *Heritage With-Profits Fund* only if the *Board* consider that such business risk will, over time, provide benefits to the with-profits policyholders in the *Heritage With-Profits Fund* and is within the limitations set out in the *Scheme*.**

**5.1.1.2 *Phoenix* will undertake business risk in the *Heritage With-Profits Fund* (including, but not limited to, the writing of additional business) only if it is not expected to (i) materially and adversely affect the reasonable expectations of existing with-profits policyholders; (ii) materially and adversely affect the quantum of any *Inherited Estate*; and (iii) impose any material constraint on the manner and timing of any distribution of any *Inherited Estate* to eligible *with-profits policies*.**

**5.1.1.3 The significant risks associated with particular business activities are carefully considered by the *Board* before being undertaken by the *Heritage With-Profits Fund* and are reviewed regularly thereafter.**

**5.1.1.4 Any profits or losses resulting from business risks allocated to the *Heritage With-Profits Fund* in accordance with the *Scheme* will fall to the *Inherited Estate*. Any such losses will be met by the *asset shares* of *with-profits policies* only if and to the extent that the *Inherited Estate* has been exhausted and the expected value of future *shareholder cashflows* has been applied to meet liabilities of the *Heritage With-Profits Fund* (other than the liability to transfer these cashflows to shareholders).**

## 5.1.2 Current Practices

### Annuities

The business in the *Heritage With-Profits Fund* includes a book of non with-profits immediate annuity business. The potential for the *Heritage With-Profits Fund* to be exposed to business risk from the annuities is limited by the *Scheme*. At the time of demutualisation the longevity risk (that is the uncertainty about how long those receiving the annuities will live) was transferred from the fund by way of a reinsurance agreement. Subsequently some of the annuity book has been reinsured with a third party. Any failure of the third party to meet its commitments would not affect the *Heritage With-Profits Fund* as the *Board* have confirmed that this risk would be covered by shareholder funds.

Following the transfer of the *SLAL* business into *Phoenix*, most annuities that are provided on the maturity of a *Heritage With-Profits Fund* policy have been written in the *Non-Profit Fund* with the purchase price being transferred to that fund. The *Scheme* includes protections for the *Heritage With-Profits Fund* where the maturing policy has its principal benefits expressed as an annuity or where it contains guaranteed annuity terms. In those circumstances the fund must be offered the *Phoenix group's* best rates for similar annuities. If the *With-Profits Actuary* nevertheless considers that the cost exceeds that which is reasonable then the annuity can be provided within the *Heritage With-Profits Fund* itself.

From the transfer of the non-UK Business to *SL International* most such non-UK annuities will be provided by *SL International* from a fund other than the *SL International* HWPF. The protections described above however remain, including the *With-Profits Actuary's* right to require the annuity to be provided from the *Heritage With-Profits Fund* if they consider that the cost exceeds that which is reasonable. In addition to this, the *Scheme* and HWPF Reinsurance Agreement terms allow for the *Phoenix* Board to require the annuity to be provided from within *Phoenix* should it determine the cost of provision by *SL International* exceeds that which is reasonable.

### Deciding to undertake new business activities in the Heritage With-Profits Fund

Whether or not to use capital in the *Heritage With-Profits Fund* to support a business activity is determined by comparing the expected risks and profitability of the activity with the benefits to our with-profits policyholders from alternative uses of capital - for example, to enhance investment freedom. If the proposed activity satisfies the limitations set out in the *Scheme* and is accepted by the *Board*, taking account of the advice of the *With-Profits Actuary* and of the With-Profits Committee, the *Inherited Estate* will provide any initial capital required.

### Management Actions

The table on the following page sets out some of the main management actions that we could take in managing the *Heritage With-Profits Fund* and includes examples of some of the most significant business risks they could be used to address:

Management Actions	Examples of Risks Addressed
Regular Bonuses We can reduce regular bonus rates, including setting them to zero, to limit the rate at which <i>guaranteed benefits</i> build up.	Build-up of <i>guaranteed benefits</i> . If <i>guaranteed benefits</i> build up too quickly it can restrict investment freedom and the prospects for final bonuses.

See Section 3.2 for further information.	
<p>Inherited Estate Distribution</p> <p>The rate of any distribution from the <i>Inherited Estate</i> can be reduced or set to zero.</p> <p>See Section 5.2 for further information.</p>	<p>Unforeseen liabilities.</p> <p>Material unforeseen liabilities attributable to the <i>Heritage With-Profits Fund</i>, for example significant remediation payments in respect of historic errors or mis-selling.</p>
<p>Guarantee Deductions</p> <p>Deductions from <i>asset shares</i> for the assessed cost of guarantees are reviewed at least annually and can be increased.</p> <p>See Section 3.8 for further information.</p>	<p>Increase in Assessed Cost of Guarantees</p> <p>The cost to the <i>Heritage With-Profits Fund</i> in respect of guarantees may change over time and be greater than was originally assessed.</p>
<p>Investment Mix</p> <p>We can adjust the mix of assets backing <i>with-profits policy asset shares</i>, for example by reducing the proportion of assets invested in equities or property.</p> <p>See Section 4.1 for further information.</p>	<p>Investment Market Performance</p> <p>Significant and sustained poor investment performance could weaken the financial position of the <i>Heritage With-Profits Fund</i> to such an extent that a reduction in investment risk is required.</p>
<p>Smoothing</p> <p>We can reduce or remove the amount of investment <i>smoothing</i> applying to with-profits <i>payouts</i>.</p> <p>See Section 3.3.2.7 for further information.</p>	<p>Financial Stress</p> <p>In circumstances of extreme financial stress continuing to apply smoothing could weaken the financial position of the <i>Heritage With-Profits Fund</i>.</p>
<p>Future Guarantee Deductions</p> <p>We can make deductions from <i>withdrawal payouts</i> for UK and Irish policies in respect of expected future deductions for the assessed cost of guarantees.</p> <p>See Section 3.8 for further information.</p>	<p>Surrenders</p> <p>An unusually high level or pattern of surrenders could weaken the financial position of the <i>Heritage With-Profits Fund</i>.</p>

The management actions described in the table could result in with-profits *withdrawal payouts* being less than they otherwise would be. We would only take actions that we believe are in the interests of our with-profits policyholders, having regard to their reasonable expectations and to the requirement to treat policyholders fairly. Where necessary we will also balance the interests of with-profits policyholders and shareholders, but subject always to treating all our policyholders fairly.



## 5.2 The Role of the Inherited Estate

### 5.2.1 Principles

**5.2.1.1 Subject to the constraints elsewhere in this PPFM, Phoenix will seek to retain an *Inherited Estate* of a size the *Board* considers appropriate to prudently cover amounts that may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*. Any *Inherited Estate* considered by the *Board* to be in excess of the amount needed for this purpose shall be distributed over time as enhancements to *payouts*.**

### 5.2.2 Current Practices

The primary role of the *Inherited Estate* is to provide for the possibility that the provisions made for the liabilities of the *Heritage With-Profits Fund* may prove to be insufficient and for any unforeseen liabilities attributable to the *Heritage With-Profits Fund*. Such unforeseen liabilities that may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme* include, but are not limited to, historic liabilities relating to the business risks undertaken by The Standard Life Assurance Company prior to its demutualisation and other losses that arise from the business risks attributable to the *Heritage With-Profits Fund*.

*Phoenix* will seek to maintain the *Inherited Estate* at a prudent level having regard to the risks borne by the Fund. In determining what is prudent the liability to transfer *shareholder cashflows* out of the *Heritage With-Profits Fund* will not be disregarded.

To the extent that the *Board* is satisfied that the *Inherited Estate* exceeds that required to meet its primary role, any excess *Inherited Estate* shall be distributed over time in a fair and equitable manner as an enhancement to *payouts* on the remaining *with-profits policies* in the *Heritage With-Profits Fund*. If the *Board* is not satisfied that the *Inherited Estate* exceeds that required to meet its primary role, no *Inherited Estate* will be distributed.

The *Inherited Estate* will in general be distributed in the form of a discretionary enhancement to fair *payouts*. So far as practicable, such distribution will be limited to *eligible policies*. The amount of any enhancement to a fair *payout* will be determined broadly as the increase that would have arisen if a small annual percentage addition had been made to *asset shares* (see Section 3.3.2.1) from the date of demutualisation. The small annual percentage addition is that which, if applied in the same way to enhance fair *payouts* for all remaining eligible policies as they become claims, is estimated to result in the entire *Inherited Estate* being distributed over time.

The rate of distribution is normally reviewed twice a year and will reduce if, for example, an unforeseen liability were to arise that materially affected the size of the *Inherited Estate*. Other factors that affect the rate of distribution include actual investment returns and the expected pattern of future claims.

*Inherited Estate* distributions will take the form of discretionary adjustments to fair payouts: they will not be added to asset shares.

The *payout* for any claim will be no lower than the *guaranteed benefit*, if any, payable in accordance with the terms and conditions of the policy for that type of claim. *Inherited Estate* distributions, will not increase such *guaranteed benefits* and so some *payouts* may be unaffected by any *Inherited Estate* distribution

The investment strategy of the *Inherited Estate* is described in Section 4.

## 5.3 Management of Additional Business

The *Heritage With-Profits Fund* closed to new business on 27 October 2023. Certain additional business may still be written in or allocated to *the Fund*.

The following *Principles* and *Practices* describe our approach to taking on such additional business in the *Heritage With-Profits Fund*.

### 5.3.1 Principles

**5.3.1.1** The *Heritage With-Profits Fund* may write additional business if it arises from increments to existing policies in the Fund, an option under an existing policy in the Fund, or in other limited circumstances set out in the *Scheme*, subject in each case to any relevant contractual obligations and the reasonable expectations of with-profits policyholders.

**5.3.1.2** The *Heritage With-Profits Fund* may also accept other additional business provided that such additional business is not expected to (i) materially and adversely affect the reasonable expectations of existing with-profits policyholders; (ii) materially and adversely affect the quantum of any *Inherited Estate*; and (iii) impose any material constraint on the manner and timing of any distribution of any *Inherited Estate* to eligible with-profits policyholders.

### 5.3.2 Current Practices

*Phoenix* will seek to offer fair terms for additional business written in, or allocated to, the *Heritage With-Profits Fund* without adversely affecting the interests of existing with-profits policyholders in the *Heritage With-Profits Fund*.

Additional business volumes, and the terms on which any such business is written, in the *Heritage With-Profits Fund*, are subject to the constraints set out in the Principles and in the *Scheme*. The *Board* will set limitations on the volumes of, and the terms on which, additional business can be written from time to time in order to comply with these constraints. In addition, the *Heritage With-Profits Fund* will operate as far as possible so that such additional business will be excluded from any distribution of the *Inherited Estate*. The *Inherited Estate* and other capital made available to the *Heritage With-Profits Fund* will nevertheless be available to support additional business that is written in it.

Currently, additional business written by *Phoenix* in, or allocated to, the *Heritage With-Profits Fund* is limited to options on existing business in the Fund, for example increments to existing policies and new entrants to existing group schemes.

The *Board* monitors the volumes of this business and will apply the limitations it considers necessary to comply with the Principles and the *Scheme*. In particular, the amount of additional business that will be accepted from the *Non-Profit Fund* will be restricted to a very low level relative to the size of the fund at demutualisation.

The only additional business that can be written by *SL International* and reinsured to the *Heritage With-Profits Fund* is set out in documentation covering the transfer of non-UK With-Profits Business to *SL International* and broadly includes:

- new policies issued as replacements for *SL International transferred policies*;
- increases to premiums or benefits in respect of *SL International transferred policies*;
- policies which would, had they been written at or prior to 29 March 2019, have been administered as increments to *SL International transferred policies*;
- policies issued on the exercise of options or rights under *SL International transferred policies* (other than non profit immediate annuities issued on the vesting of certain policies); and

- policies written in substitution of transferred policies that are cancelled.

As the *Heritage With-Profits Fund* is closed to new business, it is expected to reduce in size over time. The expected reduction in the size of the fund is not expected to require any fundamental change to the way we manage the *Heritage With-Profits Fund* for many years.

However, if the with-profits aggregate asset share falls below £875 million (adjusted annually for inflation from July 2022) the *Board* may, in accordance with the *Scheme* and with the permission of the Regulator, decide to cease to maintain the *Heritage With-Profits Fund*.

The with-profits aggregate asset share is currently very much greater than this limit. If the *Heritage With-Profits Fund* ceases, then any surplus assets of the fund will be applied in increasing the benefits of policyholders who have *with-profits policies* allocated to the fund at that time and it is expected that the policies will become non-with-profits policies. The allocation of any surplus assets will be consistent with the manner in which they would have been distributed if the fund had continued. So far as practicable, such allocation will be limited to *eligible policies*.

Should the with-profits aggregate asset share fall below the limit and the *Board* decide to continue to maintain the *Heritage With-Profits Fund*, it will state this fact along with its reasons for doing so in its annual report to policyholders.

## 5.4 Equity between policyholders and shareholders

This section describes our approach to balancing the respective interests of with-profits policyholders in the *Heritage With-Profits Fund* and shareholders.

### 5.4.1 Principles

**5.4.1.1 Shareholders are only entitled to the *shareholder cashflows* arising on specific blocks of business in the *Heritage With-Profits Fund*. Both the cashflows and the blocks of business are defined in the *Scheme*. All profits and losses and *experience adjustments*, excluding *shareholder cashflows*, arising in the *Heritage With-Profits Fund* remain within the *Heritage With-Profits Fund* and will be utilised in accordance with the *Principles* elsewhere in this *PPFM*.**

**5.4.1.2 The *shareholder cashflows* referred to in Principle 5.4.1.1 can, other than in specific circumstances defined in the *Scheme*, be varied only with the consent of the Court. Any application to the Court must be accompanied by a certificate from an independent expert to the effect that, in his opinion, the proposed variation will not materially and adversely affect the reasonable expectations of policyholders. The Financial Conduct Authority also has the right to be heard by the Court. In certain limited circumstances set out in the *Scheme*, and summarised in Appendix D, different conditions apply to the variation of these shareholder entitlements.**

**5.4.1.3 The shareholder entitlement to the *shareholder cashflows* is subject to the *Heritage With-Profits Fund* being able to continue to meet its liabilities following the transfer of the cashflows out of the *Heritage With-Profits Fund*. The *Board* will not take any action to increase the likelihood of making the transfer of the *shareholder cashflows* if such action would be contrary to policyholders' reasonable expectations or the obligation to treat customers fairly. Subject to this the *Board* is under no obligation to take any action in managing the business in the *Heritage With-Profits Fund* that would be expected to reduce the availability of the *shareholder cashflows* to shareholders.**

### 5.4.2 Current Practices

The *Scheme* sets out the cashflows that will be transferred out of the *Heritage With-Profits Fund* for the benefit of the shareholders provided that the *Heritage With-Profits Fund* can continue to meet its liabilities after the transfer. The cashflows, and the restrictions on their transfer, are summarised in Appendix D.

For business in the UK and Ireland, the cashflows include, for example, the excess of premiums over the sum of claims, expenses (including commission) and the change in best estimate reserves for *non with-profits business* and the excess of charges over the sum of expenses (including commission) and any claim amount in excess of the fair payout from units for unitised business in the *Heritage With-Profits Fund*.

*Shareholder cashflows* as described above do not arise on the business in Germany and Austria allocated to the *Heritage With-Profits Fund*. Shareholders are entitled to additional expense charges on this business as specified in the *Scheme* (see Appendix D). They are transferred out of the *Heritage With-Profits Fund* monthly in all circumstances. No restrictions apply.

The *shareholder cashflows* on UK and Irish business are available, until such time as they are transferred out of the *Heritage With-Profits Fund*, to support liabilities of *the Fund*, and will be retained in *the Fund* if necessary to ensure that it is able to continue to meet its liabilities.

If the *Inherited Estate* is extinguished, the shareholders' right to receive future *shareholder cashflows* is restricted to the extent necessary to ensure that the *Heritage With-Profits Fund* remains able to meet its liabilities. The management of the *Heritage With-Profits Fund* affects the likelihood of there being such a restriction. As specified in Principle 5.4.1.3, actions cannot

be taken to reduce this risk and thus secure the transfer of the *shareholder cashflows* out of the *Heritage With-Profits Fund* if they would be inconsistent with policyholders' reasonable expectations or the obligation to treat policyholders fairly.

The main areas of discretion which may be exercised by the *Board*, having taken account of the advice of the *With-Profits Actuary* and of the With-Profits Committee, which might have a material impact upon the ability of the *Heritage With-Profits Fund* to transfer the *shareholder cashflows* to shareholders or, conversely, affect policyholders' reasonable benefit expectations, are:

- the approach to determining whether a regular bonus is applied and, if so, the quantum of such regular bonus;
- the approach to setting *payouts* (including *smoothing*);
- the apportionment of expenses;
- the charges and deductions that may be applied (including in respect of the assessed cost of guarantees); and
- investment strategy.

We consider these below.

While it is in the interests of shareholders to limit the increase in guarantees, this is also generally in the interests of with-profits policyholders. Indeed, Principle 3.2.1.1 requires that regular bonuses are set with the aim of achieving a gradual build-up in guaranteed *with-profits policy* benefits whilst not unduly constraining the investment freedom and the prospects for final bonuses. Regular bonuses that are set in this way would also be unlikely to unduly constrain the ability of shareholders to receive the *shareholder cashflows*.

Policyholders' reasonable expectations of the *payouts* which they are to receive are, subject to any minimum benefit guarantees, largely determined by the *asset shares* referable to their policies. Sections 3.3 and 3.4 of *this PPFM* set out the approach used to calculate *asset shares*. This approach constrains the discretion of the *Board*. For example, deductions for the assessed cost of guarantees (see Section 3.8) are determined largely by formulae without the need for the exercise of discretion.

The Principles and Practices for determining *payouts* from *asset shares*, as set out in Section 3.3, also leave few areas where the *Board* can exercise discretion and, in particular, the *smoothing* practice results in *smoothing* profits and losses being recycled in the *payouts* of the remaining policyholders.

The most significant remaining area of discretion which could have a material impact upon the ability of the *Heritage With-Profits Fund* to transfer the *shareholder cashflows* to shareholders or affect policyholders' reasonable expectations is the investment strategy adopted by the Fund. However, the *Scheme* makes it clear that in exercising its discretion in this area, while the *Board* needs to have regard to a number of other constraints, it must disregard the liability of the *Heritage With-Profits Fund* to make transfers of *shareholder cashflows*.

In exercising its discretion in all matters in relation to the *Heritage With-Profits Fund* (including that of investment strategy) the *Board* will not take action to increase the likelihood of making the transfer of *shareholder cashflows* if such action would be contrary to policyholders' reasonable expectations or the obligation to treat customers fairly. Policyholders' reasonable expectations will change over time but, in assessing what constitutes reasonable expectations the *Board* will have regard to relevant policy documentation and communications to policyholders, including statements made at the time of demutualisation.

## Glossary

In *this PPFM*, the following terms shall have the meanings given below, except where otherwise specified:

**asset share** - the asset share of a policy is:

- the accumulation of premiums (less any amounts in respect of *withdrawals*, if relevant) at the *investment returns* on the backing assets, less deductions for:
  - expenses and charges;
  - any applicable mortality or other risk benefit costs or charges;
  - tax;
  - any amounts in respect of the assessed cost of guarantees provided under *with-profits policies*; and
  - where relevant, a *contribution to the capital* of the *Heritage With-Profits Fund* subject to any *experience adjustments*.

For Unitised Sub-Type III policies, consistent with policy terms and conditions, whenever claims result in a *smoothing* gain or a *smoothing* loss the *asset shares* of remaining policies are increased or reduced to reflect this.

**Board** – the Board of Directors of Phoenix Life Limited.

**bonus year** – by a bonus year, we currently mean the twelve months ending on any given 15 November.

**class of policy** – the grouping of policies used for common treatment, for example in the application of bonus rates, the determination of guarantee deductions or the determination of the mix of assets backing *asset shares*. The grouping may be different for different purposes and/or *sub-fund*, and may change over time.

**connected person** – a party connected with *Phoenix* in terms as defined in the FCA regulations.

**contribution to capital** – the contribution to the *Inherited Estate* made by *expense basis business*, through a regular deduction in the *asset share* calculation.

**counterparty risk** – the financial risk taken if a third party fails to meet its obligations to *Phoenix* under a contract entered into with *Phoenix* and / or the *Phoenix Group*.

**Declared Rate of Return** – for With Profits Pension Annuities the return that is applied, normally on the anniversary of the first annuity payment, to the then current annuity payment to determine, in conjunction with the Anticipated Bonus Rate, the annuity payment for the period until the declaration of the next Declared Rate of Return for that annuity.

**eligible policy** – that part of a policy, including non-UK policies that are reinsured back to *the Fund*, that was written before The Standard Life Assurance Company demutualised that is invested in with-profits at both the date of demutualisation and the date of claim, other than German and Austrian Suxsess policies and policies transferred from Hannover Standard Life Limited on 19 December 2004, excluding any non-contractual increments, any switches into with-profits and any increases in allocation to with-profits after the date of demutualisation.

**expense basis business** – business for which *asset shares* are determined by reference to actual expenses incurred by *Phoenix*. This is broadly all Conventional with-profits pensions

business and Conventional and Unitised sub-type I with-profits life business sold before 1 January 1995. All Irish Unitised Sub-type I business is also on an expense basis.

**experience adjustments** – adjustments that we may apply in *asset share* calculations in respect of variations between:

- (a) the actual mortality, sickness or other risk benefit experience of conventional with-profits business and the corresponding deductions made when calculating *asset shares*; and
- (b) the actual tax charged to the *Heritage With-Profits Fund* and the corresponding deductions made for tax when calculating *asset shares*.

**financial year** –the financial year is any 12 months ending on 31 December.

**the FCA** – the Financial Conduct Authority.

**the Fund** – the *Heritage With-Profits Fund* covered by *this PPFM*

**guaranteed benefits** – any minimum benefits guaranteed to be paid on dates or events specified under the relevant policy, other than the guaranteed minimum death benefit under Low Cost Plans and Minimum Cost Plans and the life cover under Homeplans.

**Heritage With-Profits Fund** – the Fund into which was transferred all of the *SLAL HWPF UK* business when the *SLAL* business transferred into *Phoenix* on 27 October 2023. It also contains Irish, German and Austrian business that is reinsured from *SL International*.

**Holding Company** - Phoenix Group Holdings, the holding company for the *Phoenix Group*.

**Inherited Estate** - the Inherited Estate is the excess of the assets of the *Heritage With-Profits Fund* over the liabilities of the *Heritage With-Profits Fund* (excluding the liability to distribute the *Inherited Estate*).

**investment element** – for a policy that is or becomes a Unitised With-Profits Policy, that part of any premium or other amount attributable to the policy (including a rebate of charges) that is applicable to the allocation of units in any unitised with-profits *sub-fund* of the *Heritage With-Profits Fund*.

**investment return(s)** – profits and losses from investments. The *investment return* used in the calculation of *asset share* is, where relevant, net of any investment management expenses which may include custodian, third party administration, registrar, auditor and regulator fees.

**maturity** – for life policies and conventional pension policies this means a claim, other than death, in the circumstances defined in the relevant contractual terms and conditions as those in which *Phoenix* has no right to reduce the unit price. For Unitised Sub-type III pension policies this means a claim other than one arising on death or *withdrawal*.

**Non-Profit Fund** – the Fund into which was transferred all the business in the *Proprietary Business Fund* when the *SLAL* business transferred into *Phoenix* on 27 October 2023.

**non with-profits business** – this includes all business relating to policies that are not *with-profits policies*, including investment-linked and non with-profits policies.

**payout(s)** – the actual benefits paid on a *with-profits policy* claim (for example on *maturity*, *withdrawal* or death).

**Phoenix** – Phoenix Life Limited, which is a life assurance company based in the United Kingdom. *Phoenix* is a wholly owned subsidiary of Phoenix Group Holdings.

**Phoenix Group** – Phoenix Group Holdings and its subsidiaries and subsidiary undertakings.

**PPFM** – the Principles and Practices set out in this document.

**Practices** – the with-profits Practices describe *Phoenix's* approach to managing the *Heritage With-Profits Fund* and to responding to changes in the business and economic environment in the shorter term.

**Principles** - the with-profits Principles are enduring statements of the overarching standards *Phoenix* adopts in managing the *Heritage With-Profits Fund* and describe the business model used by *Phoenix* in meeting its duties to with-profits policyholders and in responding to longer-term changes in the business and economic environment.

**Proprietary Business Fund** – the fund into which was written certain UK non with-profits classes of business by The Standard Life Assurance Company prior to demutualisation that were not allocated to the *SLAL HWPF* and all UK business written by *SLAL* post demutualisation other than business or elements of business allocated to the *SLAL HWPF* or *SLAL UKSMWPF*. The Irish, German and Austrian business that was written in this fund by *SLAL* was transferred to *SL International* on 29 March 2019.

**regular withdrawals** – income taken from With Profits Bonds at defined intervals as determined by the policyholder.

**representative** – we set payout calculation factors for Conventional and Unitised Sub-type I policies using specimen policies, each with characteristics that reflect the group of policies to which each payout calculation factor will be applied. We refer to these specimen policies as *representative* policies in relation to their respective groups of policies.

**Responsible Investment** – our practice of incorporating Environmental, Social and Governance (ESG) factors into investment decisions.

**Scheme** – the Scheme pursuant to Part VII of, and Schedule 12 to, the Financial Services and Markets Act 2000 that gave effect to the transfer of the *SLAL* business to *Phoenix* on 27 October 2023. Certain provisions of the Scheme applicable to the *Heritage With-Profits Fund* are summarised in Appendix D. This Scheme replaced the 2006 Scheme of Demutualisation that gave effect to the demutualisation of The Standard Life Assurance Company in 2006. The main features of the 2006 Scheme that are relevant to the management of the *Heritage With-Profits Fund* have been maintained in the current Scheme.

**smoothing** – smoothing can help to reduce the effects of fluctuations in *investment returns* that arise shortly before a claim is paid.

**shareholder cashflows** – certain cashflows defined in the *Scheme* and summarised in Appendix D that are transferred out of the *Heritage With-Profits Fund*, provided they are not required under the terms of the *Scheme* to remain in the *Heritage With-Profits Fund* to meet its liabilities.

**SLAL** – Standard Life Assurance Limited, which was a life assurance company based in the United Kingdom. The business of *SLAL* transferred into *Phoenix* on 27 October 2023.

**SLAL HWPF** - the Fund into which The Standard Life Assurance Company transferred substantially all of its existing business when it demutualised on 10 July 2006.

**SLAL UKSMWPF** - the Fund into to which was allocated the with-profits investment element of all the new Unitised Sub-type III business written by *SLAL* in the UK in its *Proprietary Business Fund* after demutualisation.

**SL International** – Standard Life International Designated Activity Company, a wholly owned subsidiary company of the *Phoenix Group* based in the Republic of Ireland.



**SL International transferred policies** – Irish, German and Austrian policies that were transferred from the *SLAL HWPF* to *SL International* on 29 March 2019 and are reinsured to the *Heritage With-Profits Fund*.

**sub-fund(s)** – notional funds within the *Heritage With-Profits Fund* in which units of a *with-profits policy* are allocated. A *with-profits policy* may have units allocated in more than one *sub-fund*. The circumstances in which any Unit Price Adjustment may apply can vary by *sub-fund*.

**this PPFM** – this document which sets out our Principles and Practices.

**transferred policies** – policies that were transferred from the *SLAL HWPF* to the *Heritage With-Profits Fund of Phoenix* on 27 October 2023.

**unit value** - the unit value in respect of a unitised *with-profits policy* is the bid price of the relevant notional *sub-fund* units multiplied by the number of units allocated to the policy concerned.

**With-Profits Actuary** – the person who from time to time is the actuary appointed by *Phoenix* to perform the role of With-Profits Actuary for the *Heritage With-Profits Fund*. The With-Profits Actuary's main duties include advising the *Board* on key aspects of its exercise of discretion in relation to the *Heritage With-Profits Fund*.

**with-profits assets** – the assets backing the *asset shares* and guarantee liabilities of *with-profits policies*, together with reserves for risks and contingencies and an appropriate part of the *Inherited Estate*.

**with-profits policy** – a contract, or the part of a contract, of insurance which is eligible to participate in discretionary distributions based on profits arising in a relevant with-profits fund. Unless the context requires otherwise, in this document the relevant with-profits fund is the *Heritage With-Profits Fund*.

**withdrawal(s)** – This term includes surrenders (either in part or in whole) of any life policy, transfers for pensions policies, switches out of any with-profits *sub-funds*, and the option to convert a With Profits Pension Annuity into a non with-profits annuity.

Where we use terms such as “appropriate”, “fair”, “necessary”, “*representative*” and “significant”, these are generally dependent on judgements made by the *Board*, using the discretion available to it, of relevant factors or circumstances concerned in the context.

## Appendix A – UK With-Profits Business

### Product Table

The following table lists the various UK products that allow investment in with-profits and gives their type.

<b>Product</b>	<b>Type</b>
Additional Voluntary Contribution Schemes	Conventional
Business Man's Policy	Conventional
Capital and Income Plan	Unitised Sub-type I
Contracted In Money Purchase (CIMP)	Unitised Sub-type I
Early Maturity Plan	Conventional
Endowment Assurance	Conventional
Endowment Assurance Master Contract	Conventional
Establishment	Conventional
Executive Pension Plan (EPP)	Unitised Sub-type I
Executive Pension Plan Pure Endowment	Conventional
Free Standing Additional Voluntary Contribution (FSAVC)	Unitised Sub-type I
Group Additional Voluntary Contribution (GAVC) Plan	Unitised Sub-type I
Group Money Purchase Pure Endowment VC Scheme	Conventional
Group Personal Pension (GPP) Plan	Unitised Sub-type I
Group Personal Pension Flex (GPPFlex)	Unitised Sub-type I
Group Personal Pension One (GPPOne)	Unitised Sub-type I
Group Personal Pension Plan for Large Employers (GPPL)	Unitised Sub-type I
Individual Buy Out Plan	Unitised Sub-type I
Homeplan	Unitised Sub-type II
Instalment Endowment	Conventional
Low Cost Plan	Conventional
Minimum Cost Plan	Conventional
Own Trust Trustee Investment Plans	TIP
Peppercorn Investment Bond (PIB)	Unitised Sub-type I
Personal Pension Flex (PPFlex)	Unitised Sub-type I
Personal Pension One (PPOne)	Unitised Sub-type I
Personal Pension Plan (PPP) (including rebate-only and some Section 226 policies)	Unitised Sub-type I
Personal Pension Plan Deferred Annuity and Pure Endowment	Conventional
Retirement Account Plan (RAP)	Unitised Sub-type I

<b><i>Product</i></b>	<b><i>Type</i></b>
Small Self Administered Scheme (SSAS)	Unitised Sub-type I
Stakeholder Pensions (including Individual, Corporate and Group Stakeholder pensions)	Unitised Sub-type III
Standing Loan Plan	Conventional
Stanplan M and own trust equivalent	Conventional
Stanplan M2 and own trust equivalent	Conventional
Transfer Plan	Unitised Sub-type I
Trustee Buy Out Plan	Unitised Sub-type I
Variable Investment Bond	Unitised Sub-type I
Variable Protection Plan	Unitised Sub-type I
Versatile Investment Plan	Unitised Sub-type I
Whole of Life Assurance (including Limited Term plans)	Conventional
With Profits Bond	Unitised Sub-type II
With Profits Pension Annuity (WPPA)	WPPA

## Bonus and Guaranteed Growth Rates

### Conventional Plans

The following table lists the Bonus Series applicable to UK products in our Conventional Range and the product groupings to which they each relate.

Bonus Series	Products
Ordinary Series	All Conventional <b>life</b> products
Reversionary Series	Conventional <b>individual pension</b> policies, including Personal Pension and Executive Pension Plans
Reversionary Bonus Series	Conventional <b>group pension</b> schemes, including Stanplan M, Stanplan M2, AVC Schemes and similar Own Trust Schemes

### Unitised Plans

The following table lists the Bonus Series applicable to UK products in our Unitised With-Profits range and the associated Guaranteed Minimum Unit Price Growth Rate for each.

Bonus Series (or name of sub-fund)	Guaranteed Minimum Unit Price Growth Rate (a year)
With Profits	3%
Life With Profits	0%
Life With Profits 2	0%
S2 Life With Profits	0%
Life With Profits 2006	0%
Life With Profits 2 2006	0%
S2 Life With Profits 2006	0%
Pension With Profits	4%
Pension 2 With Profits 2	0%
Pension With Profits One	0%
Pension Millennium With Profits	0%
Pension 2 With Profits 2 2006	0%
Pension With Profits One 2006	0%
Pension Millennium With Profits 2006	0%
Pension Inflation Plus Fund	Note 1

Note 1 The unit bid price changes in line with monthly changes in the Retail Prices Index, subject to a short delay, and so can go down as well as up.

### Published Documents

The current version of *this PPFM* and the report to UK policyholders are available on the website, [standardlife.co.uk/withprofits](http://standardlife.co.uk/withprofits)

Quarterly information on the asset mixes and credit quality of fixed interest investments backing the *asset shares* of UK *with-profits policies* is published on the same website.

## Appendix B – Irish With-Profits Business

### Conventional Policies

The following table list the main products in our Conventional Range and their bonus series.

Product	Bonus Series
Deferred Annuities	Irish Reversionary Series
EA Pension	Irish Ordinary Series
Endowment Assurances	Irish Ordinary Series
PenPlan	Irish Reversionary Series
Pure Endowment Pension	Irish Reversionary Series
Whole of Life Assurance	Irish Ordinary Series

### Unitised Policies

The following table shows the products that can invest in with-profits, the with-profits *sub-funds* in which they may have investments and, if applicable, the level of guaranteed minimum unit price growth rates for those unitised *sub-funds*.

Product	Type of With-Profits	Bonus Series (or name of sub-fund)	Guaranteed Minimum Unit Price Growth Rate (a year)
Approved Retirement Funds	Sub-type II	Retirement With Profits Fund	0%
Buy out Bond	Sub-type II	Pension With Profits Fund	4%
	See Note 1	Pension With Profits Fund A	No guarantee
Capital Savings Plan	Sub-type II	Life With Profits Fund	0%
Corporate Pensions Series	Sub-type II	Pension With Profits Fund	4%
	See Note 1	Pension With Profits Fund A	No guarantee
Executive Pension Plus	See Note 1	Standard Life With Profits Fund	No guarantee
Flexible Life Plan	Sub-type II	Life With Profits Fund	0%
Tower Pension Series	Sub-type I	Pension With Profits Fund	4%
	See Note 2	Pension With Profits Fund A	No guarantee
	See Note 2	Pension With Profits Fund D	No guarantee
MoneyWorks Plan (Gross) Moneyworks (SSIA)	Sub-type II	MoneyWorks With Profits Fund	0%
MoneyWorks Plan (Net)	Sub-type II	Life With Profits Fund	0%
Mortgage Plan	Sub-type II	Life With Profits Fund	0%
Personal Pension Plan (pre 18/11/1996 plans)	Sub-type I	Pension With Profits Fund	4%
	See Note 2	Pension With Profits Fund A	No guarantee
Personal Pension Plan (post 17/11/1996 plans)	Sub-type II	Pension With Profits Fund	4%
	See Note 1	Pension With Profits Fund A	No guarantee
Personal Pension Plus	Sub-type II	Pension With Profits Fund	4%
	See Note 1	Pension With Profits Fund A	No guarantee

<b>Product</b>	<b>Type of With-Profits</b>	<b>Bonus Series (or name of sub-fund)</b>	<b>Guaranteed Minimum Unit Price Growth Rate (a year)</b>
PRSA	See Note 1	Standard Life With Profits Fund	No guarantee
Synergy Approved Retirement Funds Synergy Investment Bond Synergy Portfolio Approved Retirement Funds Synergy Portfolio Bond	See Note 1	Standard Life With Profits Fund	No guarantee
With Profits Bond	Sub-type II	With Profits Bond Fund	0%
With Profits Retirement Annuity	See Section 3.5	Retirement With Profits Fund	See Section 3.5

Note 1 There are no *guaranteed benefits* for investments in these *sub-funds* and unit prices can go down as well as up. The *unit value* is equal to the fair payout value. Fair payout values are based on individually calculated *asset shares* (after any *smoothing*) as described in this PPFM for Unitised Sub-type II policies: there is no deduction in respect of the cost of guarantees. There are no regular or final bonuses or unit price adjustments.

Note 2 There are no *guaranteed benefits* for investments in these *sub-funds* and unit prices can go down as well as up. The *unit value* is equal to the fair payout value. Fair payout values are calculated using payout calculation factors that are derived from *asset shares* of representative policies as described in this PPFM for Unitised Sub type I policies: there is no deduction in respect of the cost of guarantees. There are no regular or final bonuses or unit price adjustments.

## Published Documents

With-profits information, including the asset mixes backing the *asset shares* of Irish *with-profits policies*, bonus information and the most up to date version of this document can be found on the website, [standardlife.ie/my-standard-life/with-profits-overview](http://standardlife.ie/my-standard-life/with-profits-overview)

## Appendix C – German and Austrian With-Profits Business

### Conventional Policies

The following table list the main products in our Conventional Range and their bonus series.

Product	Bonus Series
Aktien Rente	Single German Series
JobPlus	
KlassikPlus	
PrivatPlus	

### Unitised Policies

The following table shows the products that can invest in with-profits, the type of with-profits and, if applicable, the level of guaranteed returns on invested premiums.

Product	Type of With-Profits	Bonus Series (or name of sub-fund)	Guaranteed Return on Invested Premium (a year) <i>See Note 1</i>
Airbag	Sub-type II	HWPF Series 1	4.875%
		HWPF Series 2	2.875%
		HWPF Series 3	1.2%
CIM	Sub-type II	HWPF Series 2	2.375%
Freelax	Sub-type II	HWPF Series 2	2.375%
		HWPF Series 3	1.2%
Go!	Sub-type II	HWPF Series 2	2.375%
Support	Sub-type II	HWPF Series 2	1.2%
Suxsess	Sub-type III	HWPF Series 4	No guarantee
Swing	Sub-type II	HWPF Series 2	2.375%
		HWPF Series 3	1.2%
Vorsorgemanagement	Sub-type II	HWPF Series 2	2.875%

Note 1 The guaranteed rate that applies depends on when the contract started.

## With Profits Pension Annuity

The with-profits variant of Freelax Sofort determines a guaranteed annuity at the start of the annuity payment phase, payable for life. The guaranteed rate for Freelax Sofort changes over time based on market indicators. Each contract gets the guaranteed rate applicable at its inception. Any regular bonus granted on top of the base guaranteed benefits is also guaranteed such that the annuity can only ever rise and never fall.

## Published Documents

Information on the asset mixes backing the *asset shares* of German and Austrian *with-profits policies* can be found on the websites;

[standardlife.de](http://standardlife.de) (Germany)

[standardlife.at](http://standardlife.at) (Austria)

Fund performance information for brokers is also available online.



## Appendix D – Summary of main features of the Scheme relevant to the management of the Heritage With-Profits Fund

The information in this Appendix reflects the position of the Scheme as at the date of *this PPFM*.

### **1. Scheme History**

When Standard Life demutualised, substantially all of The Standard Life Assurance Company's existing UK and Irish branch business, together with all of The Standard Life Assurance Company's existing German branch business, was transferred to the *SLAL HWPF* by the 2006 Scheme of Demutualisation. Certain specific classes of The Standard Life Assurance Company's business were transferred to the *Proprietary Business Fund*. These classes comprise Pension Contribution Insurance policies, Income Protection Plan policies, and most Self-Invested Pension Plan policies.

On 29 March 2019 the Irish, German and Austrian business in the *SLAL HWPF* was transferred from *SLAL* to Standard Life International Designated Activity Company ("*SL International*") by the *SLAL* Brexit Scheme and simultaneously reinsured back to the *SLAL HWPF* under the *HWPF* Reinsurance Agreement. *SL International* is a subsidiary of the *Phoenix Group*. At the same time the 2006 Scheme of Demutualisation was amended to allow for this event. Because some of the Irish business reinsured back to *SLAL* under the agreement includes policies that can invest in unit linked funds that are held in *SL International* post transfer, an External Funds Link (EFL) retrocession agreement was set up between *SLAL* and *SL International* to allow these contracts to continue to have access to those unit linked funds.

On 27 October 2023 all of *SLAL*'s business was transferred to *Phoenix* by a new *Scheme* and the business in the *SLAL HWPF* was transferred to a newly created *Heritage With-Profits Fund* in *Phoenix*. The main features of the 2006 Scheme of Demutualisation that are relevant to the management of the *Heritage With-Profits Fund* were maintained in the new *Scheme*. There were some minor changes but none of these were expected to materially affect future policyholder payouts. It is this *Scheme* that is summarised in this appendix. The *SLAL* Brexit Scheme was amended at this time to move the reinsurance to the new *Phoenix Heritage With-Profits Fund*.

### **2. Shareholder cashflows**

The *Scheme* requires that certain defined *shareholder cashflows* which may arise after the Transfer Date are to be transferred out of that fund.

Such transfers are expected to be made to the *Non-Profit Fund* or to the Shareholder Fund (together, the "shareholder environment") for the benefit of shareholders, and will usually be made twice a year. These transfers are, however, subject to a number of restrictions to protect policyholders (see further in paragraph 3 below).

The defined blocks of business for this purpose comprise substantially all of the in-force UK and Irish branch business which is allocated to the *Heritage With-Profits Fund*, with the primary exceptions being conventional with-profits business and certain annuities in payment.

The calculation of the *shareholder cashflows* arising on the defined blocks differs between conventional non with-profits policies and unitised policies (i.e. unit-linked and unitised *with-profits policies*). Shareholder cashflows are paid annually on all business other than UK unitised pensions where they are paid more frequently.

- For conventional non with-profits business, the *shareholder cashflows* represent all the future profits and losses on this business other than the investment surpluses or deficits arising in respect of the assets held for this business (which accrue to the *Heritage With-Profits Fund*). Specifically, the *shareholder cashflows* for this business are calculated as premiums received minus: (i) claims incurred; (ii) initial, renewal and termination expenses determined in accordance with the terms of the *Scheme* (see paragraph 3.3 below); and (iii) commission payable. The calculation of the *shareholder cashflows* assumes that all cashflows occur in the middle of the calculation period and accrue interest. To this any reduction in best estimate reserves over the period is added, and any increase in best estimate reserves over the period is deducted. For this purpose the change in best estimate reserves is determined excluding any change caused by investment returns differing from those assumed in the calculation of the reserve at the start of the period.
- For unit-linked business, the *shareholder cashflows* represent all charges applicable to the policies minus: (i) any claim payments in excess of unit funds; (ii) initial, renewal and termination expenses determined in accordance with the terms of the *Scheme*; (iii) those investment management expenses incurred in respect of the management of the assets underlying the various unit funds (again determined in accordance with the terms of the *Scheme*); and (iv) commissions payable. These cashflows are assumed to occur in the middle of the calculation period and accrue interest.
- For unitised with-profits business, the *shareholder cashflows* are determined in essentially the same way as for unit-linked business. The differences are: (i) the annual management charge levied on unit-linked units is replaced by the equivalent deduction in respect of unitised with-profits units; (ii) allowance is made for certain claim payments in excess of the value of with-profits units after applying any terminal bonus and any unit price adjustment; and (iii) allowance is made for investment management expenses (determined in accordance with the terms of the *Scheme*) incurred in respect of the management of the assets backing *asset shares*.

For life assurance business allowance is made in the calculation of the *shareholder cashflows* for tax and tax relief at the policyholder rate applicable to life assurance companies.

Shareholder cashflows do not arise on the German and Austrian business allocated to the *Heritage With-Profits Fund*. Shareholders are entitled to additional expense charges on this business as specified in the *Scheme* (see paragraph 3.3 below).

### **3. Safeguards for policyholders**

A description of the main protections relating to the business allocated to the *Heritage With-Profits Fund* is set out below.

#### **3.1 Constraints on the transfer of assets out of the Heritage With-Profits Fund (General)**

The *Scheme* places restrictions on the transfer of the *shareholder cashflows* out of the *Heritage With-Profits Fund*. These transfers out of the *Heritage With-Profits Fund* are only permitted after an actuarial investigation and are subject to certain solvency tests specified in the *Scheme*.

Those solvency tests prevent transfers of any *shareholder cashflows* if the transfer would result in either

- (i) the elimination of the with-profits fund surplus in the *Heritage With-Profits Fund*; or
- (ii) *Phoenix* ceasing to be able to demonstrate that it is reasonable to expect the HWPF to continue to have sufficient assets to cover its liabilities.

Where the *shareholder cashflows* are negative, the *Scheme* requires the *Board* to provide (or procure the provision of) assets to the *Heritage With-Profits Fund* with an absolute value equal to the amount of the negative cashflow.

#### **3.2 Scheme Principles of Financial Management**

The 2006 Scheme of Demutualisation required that the *Heritage With-Profits Fund* must be conducted in accordance with certain “Core Principles”. The *Scheme* contains the same requirements, which are now called “Scheme Principles of Financial Management”, and comprise the following.

- The investment policy of the *Heritage With-Profits Fund* and bonus philosophy applied to policies allocated to the *Heritage With-Profits Fund* shall be determined by the *Board* (having regard to the advice of the *With-Profits Actuary*).
- The investment policy for the *Heritage With-Profits Fund*, and the bonus philosophy applied to policies allocated to the *Heritage With-Profits Fund*, must:
  - (A) be determined as if the *Heritage With-Profits Fund* were a separate mutual company (the “Notional Company”) which broadly:
    - (i) has the assets and liabilities of the *Heritage With-Profits Fund* with no obligation to transfer the *shareholder cashflows* arising on the defined blocks out of the *Heritage With-Profits Fund* or to distribute the *Inherited Estate* and with access to assets equal to the value of the liability in respect of any financing arrangements referred to in paragraph 3.2 above;
    - (ii) has, in addition and irrespective of whether or not *Phoenix* actually has any such capital, further capital available to meet its capital needs (subject to regulatory limits as apply from time to time to such capital) equal to:

- (a) tier 1 own funds with a value equal to the lesser of £579 million and 1.45% of the sum of its asset shares and assessed cost of guarantees;
    - (b) further tier 1 own funds with a value equal to the lesser of £505 million and 1.26% of its asset shares and assessed cost of guarantees; and
    - (c) tier 2 own funds with a value equal to the lesser of £526 million and 1.32% of its asset shares and assessed cost of guarantees.
  - (iii) has no counterparty risk on any transaction with any other fund of *Phoenix*, or *SL International*; and
  - (iv) has no requirement to hold a risk margin for conventional non-with-profits business that forms part of a defined block for the calculation of *shareholder cashflows*.
- (B) have regard to the nature of the liabilities of the *Heritage With-Profits Fund*, including the guarantees on *with-profits policies*, and seek to match the liabilities in respect of non *with-profits policies* allocated to the *Heritage With-Profits Fund* with assets of an appropriate nature and term; and
- (C) have regard to the reasonable expectations of the holders of *with-profits policies* allocated to the *Heritage With-Profits Fund* (if applicable, as varied by the *Scheme*) and the duty to treat them fairly.
- The bonus philosophy in respect of *with-profits policies* allocated to the *Heritage With-Profits Fund* shall recognise the intention that regular bonuses should be set at levels which do not unduly constrain investment freedom and the prospects for final bonus.
  - In order to ensure equity between different groups of *with-profits policies* allocated to the *Heritage With-Profits Fund*, other than for minor classes of *with-profits policies* where alternative methods may be used, final bonus rates in respect of such policies shall be determined in accordance with *this PPFM* by reference to *asset shares*. Subject to amendment only in respect of errors or omissions, these *asset shares* will be the *asset shares* in the records maintained by *SLAL* immediately prior to the Transfer Date. These *asset shares* shall be accumulated after the Transfer Date in accordance with *this PPFM* and, in particular, in a manner which:
    - (A) has regard to the reasonable expectations of the holders of *with-profits policies* allocated to the *Heritage With-Profits Fund* (if applicable, as varied by the *Scheme*);
    - (B) has regard to The Standard Life Assurance Company's *asset share* methodology as set out in the *PPFM* for The Standard Life Assurance Company immediately prior to demutualisation; and
    - (C) reflects the financial position, performance and experience of the *with-profits policies* allocated to the *Heritage With-Profits Fund* and the assets backing the *asset shares* of such Policies.
  - The *asset shares* at the point of transfer may be adjusted for variations between assumed and actual historic experience to the extent that this is consistent with *this PPFM* and the reasonable expectations of *with-profits policies* allocated to the *Heritage With-Profits Fund*.
  - Other than for minor classes of *with-profits policies*, subject to the effect of such *smoothing* as is implemented pursuant to *this PPFM*, and before allowing for additional final bonus (if

any) arising from the distribution of any *Inherited Estate*, *payouts at maturity* and on the vesting of *with-profits policies* allocated to the *Heritage With-Profits Fund* shall in aggregate, over time, be targeted on *asset shares*.

- The primary role of the *Inherited Estate* is to ensure a prudent amount is retained in the *Heritage With-Profits Fund* in respect of any amounts which may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*, including:
  - (A) amounts chargeable to the *Heritage With-Profits Fund* in accordance with the *Scheme*, except to the extent that such amounts are properly charged to *asset shares* in accordance with *this PPFM*;
  - (B) losses that may arise because of increases in the expected cost of guarantees or *smoothing* that cannot be recouped by deductions from *asset shares* made in accordance with *this PPFM*; and
  - (C) other liabilities attributable to the *Heritage With-Profits Fund*.
- To the extent that the *Board* is satisfied that the *Inherited Estate* exceeds that required to meet its primary role (as specified above), the excess *Inherited Estate* shall be distributed over time in as fair and equitable manner as is practicable as an enhancement to final bonus payable on the remaining *with-profits policies* which were transferred to the *SLAL HWPF* at demutualisation.
- Should the *Inherited Estate* be exhausted, any amounts that would normally be chargeable to the *Inherited Estate* in accordance with the Core Principles shall be met from *shareholder cashflows* which would otherwise be transferred to the shareholder environment.

The *Scheme* requires *Phoenix*, to the extent reasonably practicable, to conduct its business so there is no significant foreseeable risk of it being unable to meet its solvency requirements while still conducting a) the business of the *Heritage With-Profits Fund* in accordance with the *Scheme Principles of Financial Management*, and b) the business of other *With-Profits Funds* in accordance with their *Scheme Principles of Financial Management*. If such a risk does arise *Phoenix* must carry on its business to ensure it is not unduly exposed to that risk and once it has done this, *Phoenix* must conduct the business of the *Heritage With-Profits Fund* and other relevant *With-Profits Funds* so far as reasonably practicable in accordance with their *Scheme Principles of Financial Management*. The *Scheme* also requires *Phoenix* to hold sufficient assets to satisfy tests which ensure that, under certain stress scenarios, *Phoenix* will continue to hold sufficient assets of an appropriate type.

Certain *Scheme Principles of Financial Management* may be amended by the *Board* in circumstances specified in the *Scheme* if (a) the amendment is approved by the *With-Profits Actuary* and an independent expert appointed, with the approval of the Regulator, by the *Board*; (b) the amendment is consistent with the reasonable expectations of the holders of *with-profits policies* allocated to the *Heritage With-Profits Fund* and PRIN 6 and Principle 12 in the FCA handbook; and (c) the proposed amendment has been communicated to the Regulator which has either approved the amendment or not objected within three months of being informed of the proposed amendment.

### **3.3 Costs and expenses to be charged to the Heritage With-Profits Fund**

The expenses (including investment management expenses) and commissions that can be charged to the *Heritage With-Profits Fund* are limited to:

- Those which in the reasonable opinion of the *Board* (having regard to the advice of the *With-Profits Actuary*), have been incurred or will be incurred in the operation of the *Heritage With-Profits Fund*; and
- Additional amounts as specified in the *Scheme* in relation to certain policies issued in Germany and Austria.

### **3.4 Annuities**

At demutualisation, *SLAL* entered into a reinsurance agreement under which a subsidiary of *SLAL* assumed the longevity risk in relation to annuity policies which were allocated to the *SLAL HWPF* and which were in payment at demutualisation. Under the 2006 Scheme of Demutualisation, the *Board* was required to ensure that if this reinsurance terminated, alternative arrangements, which were not materially less beneficial to the *SLAL HWPF* than the previous reinsurance, would be implemented. Such alternative arrangements are now in place with part of the business being reinsured with a third party and the longevity risk for the remainder being borne by the *Non-Profit Fund*. There are a small number of German and Austrian annuities in payment in the *Heritage With-Profits Fund* and these are not subject to the reinsurance arrangements just described.

Since the Transfer Date, most annuities that are provided on the maturity of a *Heritage With-Profits Fund* policy are written in the *Non-Profit Fund* with the purchase price being transferred to that fund. The *Scheme* includes protections for the *Heritage With-Profits Fund* where the maturing policy has its principal benefits expressed as an annuity or where it contains guaranteed annuity terms. In those circumstances the fund must be offered the *Phoenix group's* best rates for similar annuities. If the *With-Profits Actuary* nevertheless considers that the cost exceeds that which is reasonable then the annuity can be provided within the *Heritage With-Profits Fund* itself.

In addition to the protections for the *Heritage With-Profits Fund*, further similar protections were introduced when the non-UK business was transferred to *Standard Life International Designated Activity Company*, and reinsured back. These give the *Phoenix Board* and the right to retain annuities in *Phoenix* post vesting, when they would ordinarily cease to be reinsured as they leave the *Heritage With-Profits Fund*.

### **3.5 Amounts payable to Standard Life International on the termination of the HWPF Reinsurance Agreement**

Amounts in respect of Termination Payments under the HWPF Reinsurance Agreement can only be paid out of the *Heritage With-Profits Fund* if solvency tests as described in 3.1 of this appendix are met.

A specified element of the termination amount will always be met by the shareholder fund.

### **3.6 The posting of assets as collateral in relation to the HWPf Reinsurance Agreement with *Standard Life International***

Only assets backing non-UK *asset shares*, non-UK non with-profits policies and reserves for outstanding claims and accounting liabilities for non-UK policies can be posted as collateral (that is made subject to the fixed charge).

### **3.7 Transactions in the Heritage With-Profits Fund**

*Phoenix* may only enter into a material transaction or arrangement with any *Phoenix* fund or person, which affects the property or liabilities of the *Heritage With-Profits Fund*, if that transaction or arrangement is on terms which, in the opinion of the *Board* (having regard to the advice of the *With-Profits Actuary*), is unlikely to have a material adverse effect on the interests of the holders of *with-profits policies* allocated to the *Heritage With-Profits Fund*. Where such a transaction will involve a loan of *Heritage With-Profits Fund* assets, or the giving of a guarantee backed by *Heritage With-Profits Fund* assets, there are additional restrictions set out in the *Scheme*, including an obligation on the *Board* to ensure that the loan or guarantee is beneficial to the holders of *with-profits policies* allocated to the *Heritage With-Profits Fund*.

## **4. Future distribution of profits to with-profits policyholders**

Subject to the constraints imposed by the *PPFM* and the provisions of the *Scheme*, surplus assets in the *Heritage With-Profits Fund* may only be distributed to holders of *with-profits policies* allocated to the *Heritage With-Profits Fund*.

As explained in paragraph 3.2 above, the primary role of the *Inherited Estate* is to ensure that a prudent amount is retained in the *Heritage With-Profits Fund* in respect of any amounts which may be charged to the *Heritage With-Profits Fund* in accordance with the *Scheme*. To the extent that the *Board* is satisfied that the *Inherited Estate* exceeds that required to meet this primary role, then the excess will be distributed over time in as fair and equitable manner as is practicable as enhancements to *payouts* on *with-profits policies* allocated to the *Heritage With-Profits Fund*.

## **5. Additional business**

The *Scheme* restricts the additional business that can be written in the *Heritage With-Profits Fund*. Certain specific categories of additional business (for example, increments to policies transferred into the *Heritage With-Profits Fund* at demutualisation) may always be written in the *Heritage With-Profits Fund*. Other business can only be written in the *Heritage With-Profits Fund* if the *Board* is satisfied that the writing of the business will satisfy the following:

- it must not be expected to materially and adversely affect the quantum of the *Inherited Estate* or impose any material constraint on the manner and timing of its distribution;
- it must not be expected to materially and adversely affect the reasonable expectations of with-profits policyholders allocated to the *Heritage With-Profits Fund*; and
- it must not otherwise be inconsistent with the Scheme Principles of Financial Management or *this PPFM*.

In addition, the *Heritage With-Profits Fund* must be remunerated appropriately for the use of its capital, and the risks which it is assuming in writing or accepting such new business.

## **6. Taxation**

The *Scheme* provides that taxation will be charged on the *Heritage With-Profits Fund* on the basis that the fund constitutes the whole of the long term fund of a mutual life assurance company carrying on business in the United Kingdom and elsewhere with no business other than the business carried on in the *Heritage With-Profits Fund*.

## **7. Maintenance of the Heritage With-Profits Fund**

If the with-profits aggregate asset share falls below £875 million (adjusted annually for inflation from July 2022), the *Board* may decide (having regard to the advice of the *With-Profits Actuary* at that time) to cease to maintain the *Heritage With-Profits Fund*, subject to the Regulator's approval (such approval is not required if the with-profits aggregate asset share falls below £175 million, adjusted annually for inflation from July 2022). In such circumstances, the surplus assets of the *Heritage With-Profits Fund* will be applied in increasing the benefits of holders of *with-profits policies* allocated to the fund at that time and the policies are expected to become non- *with-profits policies*.

## **8. Changes to the Scheme**

Any variation to the terms of the *Scheme* can usually only be implemented if the Court approves the requested variation. If the *Board* makes an application to the Court for such a change to be made then the *Scheme* requires that: (i) the Regulator shall be notified of, and have the right to be heard at, any hearing of the Court at which the application is considered; and (ii) the application must be accompanied by a certificate from an independent expert to the effect that, in his opinion, the proposed variation will not materially and adversely affect the reasonable expectations of the holders of the policies transferred from The Standard Life Assurance Company to Standard Life under the *Scheme*.

Variations may (with the approval of the *With-Profits Actuary*) also be made to the *Scheme* in order to correct manifest errors and (with the approval of the *With-Profits Actuary* and the Regulator) in order to reflect changes, or proposed changes, to application legislation or regulations which may affect the intended manner in which the *Scheme* is to operate.

## **9. Standard Life's Mortgage Endowment Promise**

Towards the end of 2000, the Standard Life Assurance Company ("SLAC") issued the Mortgage Endowment Promise (the "MEP") to certain of its policyholders ("MEP Policyholders") in respect of their mortgage endowment policies ("MEP Policies"). A letter was sent to MEP Policyholders which promised that the MEP Policy would meet its target amount ("Target Amount") at *maturity* provided the future earnings on the assets in which the MEP Policy was invested were on average at least 6% each year (after tax). This was subject to the future growth in the capital of SLAC being enough to allow it to set aside regular provisions to meet any possible shortfalls (the "Capital Growth Condition"). The amount by which the Target Amount exceeds the *maturity* value of the MEP Policy is referred to below as the "Shortfall Amount". Payment of the Shortfall Amount was thus dependent, inter alia, upon the average *investment return* on the assets in which the MEP Policy was invested in the period from 28<sup>th</sup> September 2000 (when the MEP was announced) to *maturity* being equal to, or in excess of, 6% per annum (after tax) (the "6% Per Annum Test").

Shortly after that letter was sent to MEP Policyholders, a further letter was sent by SLAC to each MEP Policyholder holding a MEP Policy (a "Top-Up MEP Policy") which at its first review ("First Review") after the introduction of the MEP was projected to achieve its Target Amount only if the assets in which it was invested were to earn, on average, in excess of 6% per annum (after tax) from 28<sup>th</sup> September, 2000 to *maturity*. In that letter, SLAC promised to pay the



excess (the “Maximum Top-Up”) of the Target Amount over the projected *maturity* value of the Top-Up MEP Policy at the First Review, calculated on the basis of future *investment returns* on the assets in which the MEP Policy was invested of 6% per annum (after tax). This was again subject to the Capital Growth Condition, but not the 6% Per Annum Test.

The 2006 Scheme of Demutualisation reconstituted the MEP and transferred it to *SLAL* (allocating the liability to make payments under it to the *SLAL HWPF*). The MEP has now transferred to *Phoenix* and operates as described below.

## **MEP payments**

Subject to its not exceeding the Shortfall Amount, the amount payable under the MEP will be either:

- the Shortfall Amount if the 6% Per Annum Test is satisfied in relation to a MEP Policy or;
- the Maximum Top Up or Shortfall Amount, if less, if the 6% Per Annum Test is not satisfied in relation to a Top Up MEP Policy

Unless the 6% Per Annum Test is satisfied, payments will be only made under the MEP to Top Up MEP policies.

## **Eligibility**

In order to qualify for a payment under the MEP, a MEP Policyholder must satisfy certain eligibility criteria. These are that from its First Review up to the policy maturity date:

- all premiums must be paid in full;
- all premiums must be invested only in with-profits or the managed fund (or a mixture of both);
- the premium amount must not be reduced (except as a result of the policy being altered from joint life to single life);
- the policy term must not be altered;
- the policy must not be partially or fully surrendered (including where any early maturity option is exercised) or paid up; and
- the policy must not be absolutely assigned to a third party (except in the case of divorce).

Phoenix Life Limited, trading as Standard Life, is registered in England and Wales (1016269) at 1 Wythall Green Way, Wythall, Birmingham, B47 6WG.

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