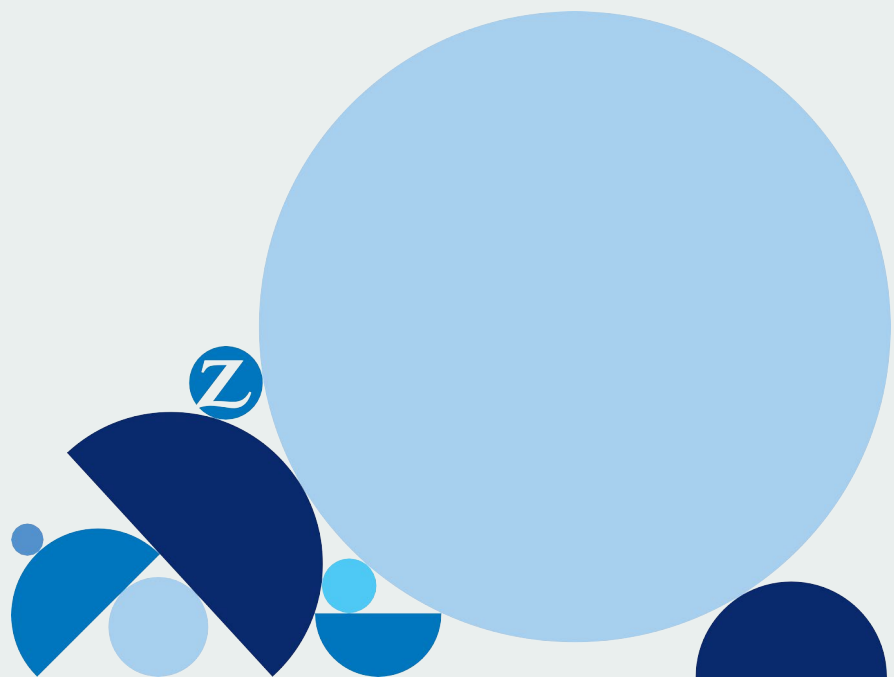


# Principles and Practices of Financial Management

for the

**Zurich Assurance Ltd 90:10 With-Profits Fund**



## Amendments to this PPFM

This is the 15th version of this PPFM with changes made to:

- a) reflect the introduction of the FCA's Consumer Duty which outlines how firms must act to deliver good outcomes for retail customers,
- b) confirm all investments made before 1 January 2023 will benefit from Estate distribution,
- c) reflect that our main source of new business is now protection business,
- d) narrow the range within which surrender values will be targeted when assessing whether payouts have been within the published ranges
- e) clarify whether claims are considered as maturities or surrenders when assessing whether payouts have been within the published ranges
- f) update the size of the Estate and allow for an acceleration of its distribution, and
- g) provide updated information on the expenses borne by the fund.

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# Introduction

These **Principles and Practices of Financial Management** are applied by Zurich Assurance Ltd (ZAL or we) in managing the with-profits business, originally written by Eagle Star Life Assurance Company Limited (ESLACO), in its **90:10 Fund** (the **Fund**). They play an important role in the governance of this business and ensuring our customers receive good outcomes.

## Principles

- reflect the **general approach** adopted
- aren't expected to change often.

ZAL's Board may amend these Principles if they reasonably consider that:

- a) they could lead to poorer outcomes for some classes or groups of customers within the **Fund** or prevent the sound and efficient financial management of the business in the **Fund**; or
- b) an amendment would achieve a better balance of good outcomes in respect of all classes or groups of customers, and not increase or introduce the possibility of poorer outcomes in respect of any particular classes or groups of policyholder.

If the With-Profits Actuary believes any proposed amendment will, or may, have a material adverse impact on the rights, or reasonable expectations, of any class or group of customers, they'll give notice of the proposed change to our regulator, the Financial Conduct Authority (FCA). The change won't take effect for 1 month to allow the FCA time to confirm they don't object or serve a written notice of objection to the Board.

We'll make reasonable efforts to notify all customers of any changes to the Principles at least 3 months prior to their effective date.

## Practices

- confirm **specific practice** used
- reflect ZAL's approach based on current regulatory, business and economic environment
- likely to change in line with these factors and development of new methods and techniques in the life insurance industry.
  - speed and extent of change will depend on the circumstances triggering it

ZAL's Board will receive advice from the With-Profits Actuary, who will regularly monitor the methodology, assumptions and controls as they apply in practice.

Where they determine a change to Practices is appropriate, the Board will delegate the setting and delivery of the detail of the changes to a specified group of senior managers, which will include the With-Profits Actuary. This group will individually and collectively have responsibility for:

- a) determining and agreeing the details of the proposed changes,
- b) referring back to the Board if issues cannot be resolved or if it's felt appropriate for them to discuss and agree the details,
- c) ensuring that the Independent Person has sufficient time (normally 4 weeks) to consider and comment on material proposed changes to practices,
- d) documenting changes to the PPFM and ensuring previous versions of it are kept for at least 6 years,
- e) ensuring revised procedures and systems are properly documented,
- f) ensuring that implementation of change is properly managed using appropriate change controls, and
- g) ensuring customers (and, if appropriate, the FCA) are notified of changes to Practices, including, where relevant, publishing details of these changes on our web site within a reasonable timescale and ensuring that customers are given written details of changes in their next with-profits update.

# Structure of Zurich Assurance Ltd and its Funds

## Zurich Assurance Ltd

Eagle Star Life Assurance Company, which wrote with-profits business, changed its name to Zurich Assurance Ltd shortly before 1 January 2005 when, as a result of a court sanctioned scheme of arrangement, other UK long-term business of the Zurich group was transferred to the company. ZAL's ultimate parent and controlling company is Zurich Insurance Group Ltd (incorporated in Switzerland).

Since 2002, ZAL's been closed to new with-profits business and has limited new investment in the **Fund** to where acceptance is required under terms and conditions of existing policies. We reserve the right to exclude any new investment made into the fund after 1 January 2023 when determining any distribution of the Estate.

We continue to write new non-profit business, mainly protection policies.

Most of ZAL's business originates from the UK but we still have some policies in force that were written in Hong Kong, Malta, the Isle of Man and the Channel Islands.

- The Maltese, Channel Islands and some of the Isle of Man business has similar terms and conditions to those of the UK policies and is managed by ZAL alongside the UK business  
*(Benefits on the Maltese policies are denominated in Euros, but otherwise are the same as the equivalent UK policies).*
- The Hong Kong business and the rest of the Isle of Man business was written on different terms and is largely managed by ZAL's overseas branches.

**In this document, we've referred to "UK-type" and "overseas-type" business to cover the business managed in the UK and overseas respectively.**

## Fund structure

ZAL consists of 4 Long Term Business Funds and a Shareholder Fund.

### Long Term Business Funds (LTBF)

#### 90:10 With-profits Fund (**Fund**)

The **Fund** contains conventional with-profits and unitised with-profits business that was mostly written prior to 1995 (with a relatively small amount of incremental business written more recently).

The **Fund** operates based on a 90:10 split of any distributable surplus – with customers sharing in 90% and shareholders entitled to the remaining 10% via a transfer to the SH Fund.

#### 100:0 With-profits Fund (100:0 Fund)

In 1995, we launched a new series of unitised with-profits business held in the 100:0 Fund. The shareholders' interest in this business arises from the difference (if any) between the specific management charges levied by ZAL under the policy terms and conditions and all the costs incurred in relation to the business (i.e. the cost of writing and administering the business, including commission related costs, investment management fees and risk benefit claims). All of the investment return (after charges and less any applicable taxation) will be distributed over time to the customers in the 100:0 fund in the form of guaranteed benefits or bonus. There's no overseas-type business in the 100:0 fund.

### Defined Charge Participating Fund (DCP Fund) & Non-Profit Fund (NP Fund)

The DCP Fund and NP Fund contain non-profit conventional and unit-linked business.

Unit-linked customers' benefits are determined by the value of the units they hold – with the value of each unit dependent on the investment return on the assets of the specific unit-linked fund less charges and taxation.

If a surplus arises in the DCP Fund in any year between 2005 and 2024 inclusive, then 1% of that surplus will be transferred to the **Fund** (subject to a maximum of £1m, increasing in line with the UK Retail Prices Index, in any one year).

Apart from as described above and the support mechanism described in Appendix B, all profits from the business in the DCP Fund and NP Fund belong to shareholders. Customers' benefits are determined by the relevant policy conditions and there's no policyholder participation in those profits.

### Shareholder Fund (SH Fund)

The SH Fund contains assets which belong entirely to shareholders, including amounts built up from past profits or losses from the long-term business. Customers have no direct interest in the assets of this fund.

Separate assets are allocated to each of the LTBFs, and each fund has its own investment strategy.

Within the **Fund**, different asset mixes are maintained for UK-type business and for each overseas-type business.

For UK-type business, currently we maintain 3 separate asset mixes

1. life plans, unitised pension plans and Esitran plans,
2. other types of conventional pension plans, and
3. assets backing guarantees, options and the Estate.

We manage the 4 LTBFs so that, under normal circumstances, only the assets of each fund is used to meet the liabilities of that same fund. This approach has been accepted by the Financial Conduct Authority (FCA).

However, under insurance company law, the 4 LTBFs are counted as one fund so all the assets are, in theory, available to meet their collective liabilities. We recognise this by making financial support available for the **Fund** and/or the 100:0 Fund, as necessary, from the DCP Fund, the NP Fund, or, in certain circumstances, the SH Fund (see Appendix B).

Financial support means either

- a transfer or notional allocation of assets in excess of that which occur in the normal operation of the business or
- foregoing an entitlement to a transfer of assets or charge on the with-profits fund

so support may be temporary or permanent in nature depending on the circumstances at the time.

The 100:0 Fund will only provide financial support for the **Fund** (and vice versa) in extreme circumstances (e.g. to avoid insolvency) and neither fund will provide financial support for the DCP, NP or SH Funds.

## Sharing of surplus arising in the Fund

Surplus arises in the **Fund** from several sources - the main one being the difference between actual investment returns and those allowed for in valuing the guaranteed benefits policyholders are entitled to.

Surplus arising in a given year can be either positive or negative (also known as a deficit).

Surplus is distributed to policyholders in the form of bonuses. The amount to be distributed will depend on the amount arising - however, this may be increased by including some of the retained surplus from previous years held in the Estate (described on page 26), or some of that year's surplus may be held back and used to increase the Estate.

Some of the bonus allocated to policies serves to increase the value of current claims, and some is held back to increase the value of benefits in the future. For a given policy, the cost of any bonus added to current claims is effectively a cash amount, whereas the cost of any bonus added to future benefits is a discounted amount which is added to the Company's technical provisions held in respect of that policy.

90% of surplus from the **Fund** is shared between policyholders with the other 10% allocated to shareholders – so for every £9 which goes towards the cost of bonus allocations to policyholders, shareholders receive £1.

Any tax liability in respect of a distribution of surplus is attributed to the Estate so asset shares are unaffected – however, for distributions made prior to 30 June 2005 any tax liability was attributed to asset shares.

Since 1 January 2007 any Market Value Reductions (MVRs see page 13) deducted from policyholder claims have been allowed for in calculating the amount of the surplus allocated to shareholders.

# Guiding principles

These Principles are considered when applying the specific principles and practices set out in later sections – and take precedence where any conflict is identified. We believe them to be consistent with the FCA’s Principles for Businesses, but should any conflict arise the FCA’s principles would take precedence.

Responsibility for managing the business of the **Fund**, in accordance with these Guiding Principles and other principles set out in this document, lies with the ZAL Board, taking account of advice from the With-Profits Actuary. In setting them, the Board has tried to consider all likely circumstances and conditions that might affect the **Fund** going forward and they’ll use all reasonable efforts to ensure we act in line with these Principles. However, it’s possible that, in extreme circumstances, it may be necessary to depart from these Guiding Principles to minimise any financial risks to the Fund.

Where changes in legislation, or regulations, governing our business mean it’s necessary to modify these Principles the Board will carefully consider what changes are necessary, taking advice from those noted under Governance on the next page, and will keep all affected customers fully informed.

We won’t normally change the approach, methodology or assumptions underlying these Principles and will take all reasonable steps to ensure that we are able to apply them consistently. However there may be circumstances where, in the opinion of the Board, changes to these Principles and their application in practice might be necessary. Examples of circumstances where the Board might consider such a change include, without limitation, those which would serve to:

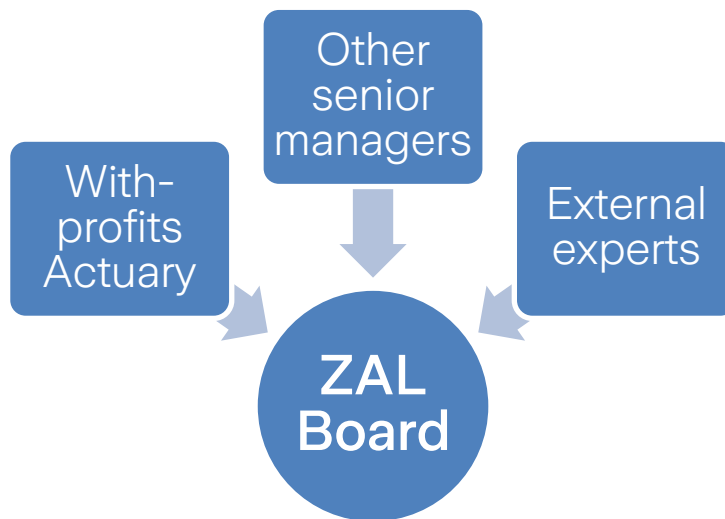
- protect the financial position of the **Fund** as necessary in adverse circumstances,
- improve the accuracy of the methods used,
- correct any material errors,
- ensure compliance with changes in taxation, regulation or regulatory guidance; or
- make appropriate allowance for any previously unidentified influencing factors.

Controls and documentation (Appendix A) confirms in more detail circumstances which may lead to changes being made.

The **Guiding Principles** in order of precedence in which they apply, are:

- 1** ZAL will manage its entire business in a sound and prudent manner, and in accordance with its Memorandum and Articles of Association, with the objective of ensuring that all relevant legal and regulatory requirements will be met, including, without limitation, those established by the UK regulator in respect of the adequacy of financial resources supporting the business and those set out in the policy conditions.
- 2** ZAL will manage the **Fund** with the objective of ensuring that all guaranteed benefits in respect of policies in the fund, including annual bonuses declared to date, can be paid from the available resources of the **Fund**.
- 3** ZAL will manage the **Fund** with the objective of delivering good outcomes and providing fair value, for customers - taking into account the relative interests of both customers and shareholders, the level of guaranteed benefits and the available financial resources of the **Fund**. In particular, we’ll aim to fairly distribute the assets of the **Fund** over the remaining lifetime of the policies invested.  
What represents good outcomes and fair value will be determined and reviewed by the Board taking into consideration, amongst other things: our customer communications, relevant guidance from the FCA and what they understand to be typical UK market practice for with-profits business – with “fairness” being applied across broad groups and generations of customers.
- 4** ZAL will aim to reduce the volatility of returns to customers through appropriate management of the **Fund** using a degree of smoothing and approximation when calculating the amounts payable on claims. This is to even out the impact of favourable and unfavourable investment experience over time, and to reflect the pooled investment experience of different policies and policy groups within the **Fund**. As we’ll aim to manage the cost of smoothing within the **Fund**’s available financial resources over the medium to long term, the degree of smoothing, and approximation, applied may vary
- 5** Subject to abiding by the principles and practices described, ZAL will aim to manage the **Fund** from within the fund’s own resources. However, if the Board, with advice from the With-Profits Actuary, considers them insufficient to meet those objectives, we may supplement the resources of the **Fund** with temporary or permanent financial support from the DCP Fund, NP Fund or SH Fund - provided it’s made available on financial terms which the Board considers to be reasonable from the point of view of the **Fund**. The means of providing support to the **Fund** is described in Appendix B.
- 6** The assets of the **Fund** won’t be used to provide financial support to the 100:0, the DCP or the NP Fund except to the extent required or permitted by law in the event of insolvency or if, in the opinion of the Board, there is a serious risk of insolvency.  
If the Board deems such financial support to be necessary, it will make all reasonable efforts to ensure support is provided on terms that minimise any financial disadvantage to customers in the **Fund**.
- 7** The assets of the **Fund** will not be used to provide financial support to the SH Fund or to any other company within Zurich Insurance Group Ltd.

# With-profits Governance



To meet its responsibilities for managing the **Fund's** with- profits business, the ZAL Board:

- is advised on the exercise of its powers of discretion by the With-Profits Actuary.
- engages the advice of ZAL senior managers with knowledge and experience of the with-profits business.
- regularly refers to external experts to make sure it maintains an appropriate level of independent review to ensure its management of the **Fund** is consistent with its stated principles and practices.

We have well-established procedures to ensure the Board can satisfy itself, at regular intervals, that the with-profits business is being managed in accordance with this PPFM.

By 30<sup>th</sup> June each year (for the previous calendar year), we'll publish our annual report which tells customers whether, in the opinion of the Board:

- ZAL has complied with its obligations in this PPFM
- the way it exercised discretion was appropriate
- it's addressed any competing or conflicting rights, interests or expectations of its customers and shareholders in a reasonable and proportionate manner.

with specific reference to the following areas:

- bonus rates
- investment strategy
- surrender values
- expense incurred and charges made
- changes to the PPFM
- communications with customers.

A separate report is also prepared by the With-Profits Actuary giving their opinion on whether ZAL has applied its discretion in a reasonable and proportionate manner.

## Structure of the business in the **Fund**

### Types of with-profits contracts

There are two main types of with-profits contracts within the **Fund** – conventional and unitised – with very different underlying product structures.

#### Conventional with-profits (CWP)

There's a guaranteed amount payable on a specific event or date stated in the policy conditions.

This may be defined as a:

- single lump sum payment (Sum Assured) or
- series of payments (Annuity or Pension).

The guaranteed amount can be increased by the addition of bonuses (as described on page 13).

A different guaranteed amount may be payable on other events, such as on death.

#### Unitised with-profits (UWP)

A percentage of the premiums paid is allocated to units in the **Fund**.

On some policies units may be cancelled to meet, for example, expense charges, the cost of life cover or other benefits.

The allocation percentage and charges can be found in the policy conditions.

The policy benefits are based on the nominal value (number of units attaching to a policy times the bid price) - subject to certain adjustments as described below.



# Amounts payable on claims

In summary, claims from policies in the **Fund** fall into 3 categories:

Claim type	Policy Type	When is this paid?	What value is paid?
Maturities	Non-Whole of Life	The date on which the policy proceeds are finally paid as stated in the policy schedule.	Claim value <ul style="list-style-type: none"> <li>won't be less than any guaranteed minimum amount.</li> <li>may be increased by a final bonus but will not be reduced by a Market Value Reduction (MVR).</li> </ul>
	Pensions	The selected retirement date stated in the policy schedule	
Surrenders	All	On any date other than the contractual maturity date or death	Claim value <ul style="list-style-type: none"> <li>generally based on the nominal value of the underlying with-profits units, although they may be subject to certain policy specific deductions as described in the policy conditions.</li> <li>may be increased by a final bonus or reduced by an MVR</li> </ul>
Death**	All	On death	Claim value <ul style="list-style-type: none"> <li>dependent on the contractual terms of each policy type, as defined in the policy conditions.</li> <li>may be increased by a final bonus but will not be reduced by an MVR.</li> </ul>

\* Final bonus is also known as terminal bonus

\*\* We've used the term "death claims" generally to describe claims on death or on certain other events, such as diagnosis of a defined serious illness.

## Principles

- Amounts payable on maturity or death will be at least any guaranteed amounts payable under the policy conditions. Payments on maturity or death may be increased by a final bonus.
- Surrender values for policies in the **Fund** will be calculated in line with the policy conditions and may be increased by a final bonus or reduced by an MVR.
- Except where guaranteed amounts apply, we'll aim to apply smoothing to claim values using the bonus mechanism. The degree to which smoothing can be applied will depend on the current and projected future financial position of the **Fund**. The degree of smoothing applied to surrenders may be less than that applied to maturity or death claims.
- Amounts payable on maturity, surrender or death may be increased by the addition of regular and/or final bonuses. For UWP policies and CWP group deferred annuity pension schemes, the amount payable on surrender (other than at a Guarantee Date) may be reduced by the application of an MVR.  
For all policy types, any final bonuses and MVRs that may be applied will be set taking account of asset shares, the underlying level of guarantees and the financial circumstances of the **Fund** at the time of the claim. Appendix A sets out in more detail how asset shares are calculated.
- As the application of bonuses, MVRs and smoothing all involve a degree of approximation, we'll determine payouts using the average levels of benefits across groups of policies (rather than to individual policies), except where guaranteed minimum payout levels apply.
- Any changes to the methods used to calculate amounts payable are approved by the Board, taking account of advice from the With-Profits Actuary.

## Practice

Any changes to our Practices in respect of claims will be approved by the Board and will be implemented as soon as reasonably practical.

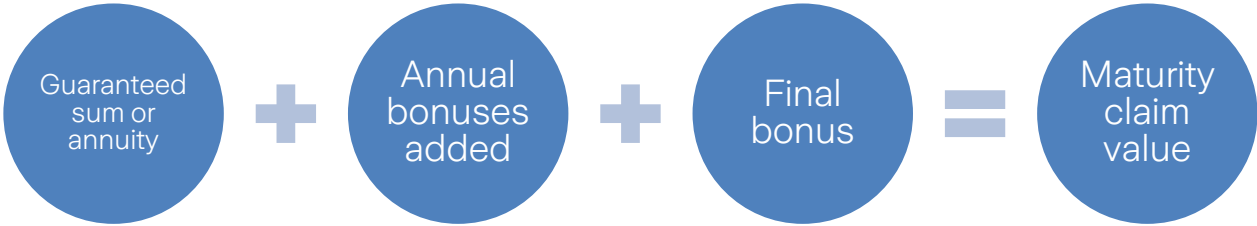
Any change to claim calculation bases due to changes in the circumstances of the **Fund**, may be applied subject to approval from the With-Profits Actuary, and the Board will review the changes at the next available opportunity.

All customers affected by a change in practice will be updated about the change with their next with-profits update.

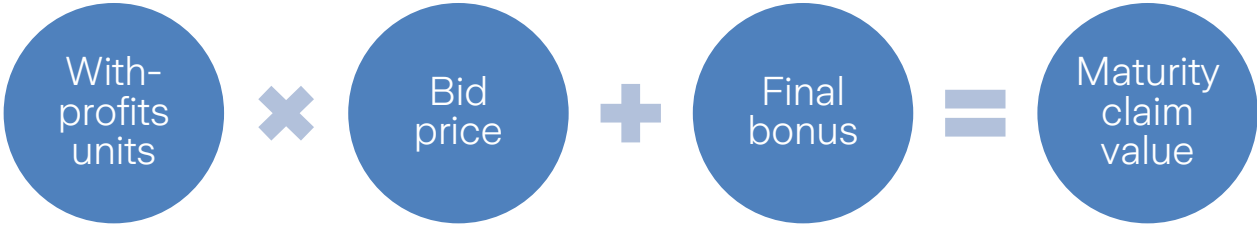
A summary of the practices relating to overseas-type business can be found in Appendix C.



Amounts payable on maturity  
Components of a maturity claim  
CWP policies



UWP policies other than those investing in Series 1

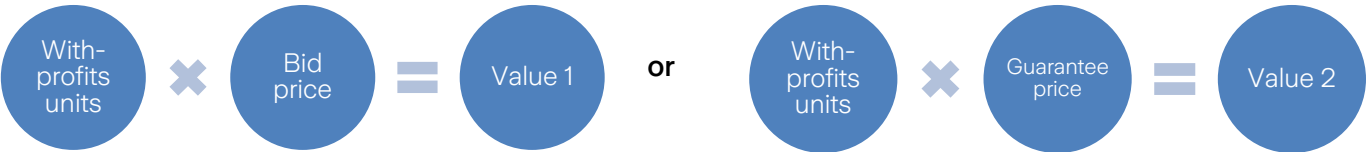


Series 1 UWP policies

For Series 1 UWP, there are 3 unit prices:

Name	When's this price used?	How's this price set?
Offer price	When units are allocated	Responds actively to movements in the value of the underlying assets on a daily basis, so less smoothing applies than on other UWP series in the <b>Fund</b>
Bid price	When units are cancelled on any date other than a Guarantee Date	
Guarantee price	When units are cancelled on a Guarantee Date (such as contractual maturity date or on a death claim) <b>if this is higher than the bid price</b>	When this Series 1 UWP fund was launched, this was set as 75% of the initial offer price and was guaranteed to grow each year by at least 35% of the yield at the start of the calendar year on 2.5% Consols (an undated UK Government loan stock).  As 2.5% Consols were an undated stock, the government repaid them when, in 2015, the yield reduced to below 2.5%.  Since then we've applied a guaranteed rate of increase of 35% of the yield on the 20 year Gilt index, subject to a minimum of 2.5% - so this price increases by a minimum 0.875% per year.

So the component parts for these policies are:



with **the highest value paid** on maturity claim

No explicit bonuses, or MVR, can be applied to policies investing in Series 1 UWP, however:

- where value 1 is paid, the difference between it and value 2 is treated in the **Fund** as if it were a terminal bonus – and a 10% shareholder transfer generated, and
- any increase in the guarantee price over and above the guaranteed minimum increase is treated in the **Fund** as an annual bonus – and a 10% shareholder transfer generated.

Calculation of payouts on maturity

As the **Fund** is closed to new business, the financial resources available to meet payouts are finite so our objective is to achieve an orderly run-off of these resources over the remaining lifetime of the policies investing in the **Fund**.

We manage this by periodically considering the current and projected future position of the **Fund** based on what we believe to be realistic assumptions for future experience. The process is described in more detail on page 26, but essentially means we retain sufficient assets to meet the expected level of guaranteed benefits and use the balance to provide additional benefits in a way that's consistent with the principles and practices detailed.

In applying this approach, we take into account the current and projected future level of asset shares on policies in the **Fund**. "Asset shares" are described in more detail in Appendix A, but essentially, they represent the accumulated

contribution of each policy to the **Fund** and may include allowance for an enhancement as a result of the distribution of the Estate. We determine the level of maturity payouts based on a percentage of asset shares we expect to be able to sustain over the medium to long term, subject to allowing for any guaranteed minimum payouts on policies which might exceed the underlying asset share. For products where there are few policies remaining, asset shares aren't calculated and the bonus rates set to those of the most similar product for which asset shares are calculated.

This "target" payout percentage:

- represents an average level across all policies,
- is normally reassessed at least annually, and
- is likely to change in response to changing conditions and experience (and as indicated below any changes will be reflected in the terminal bonus scales).

More frequent changes in the target payout percentage may be made when investment conditions are changing rapidly. We regularly assess whether we're meeting this target by comparing the unsmoothed asset share of each maturing policy to its maturity value.

Currently, we expect payouts on maturity to be targeted at a percentage of asset shares across the business in the **Fund** as a whole and we're currently targeting 100% of asset share (except for Esitran policies, see below).

Our target is for at least 90% of maturity payouts to be between 80% and 120% of unsmoothed asset share – excluding policies where the guaranteed minimum payout exceeds 120% of the underlying asset share. Bearing in mind the benefits customers can gain from smoothing, we consider that the range is appropriate and fair.

In practice, it may not be possible to achieve payouts that always meet this target because of the impact of, for example,

- policy terms and conditions (such as the presence of guaranteed minimum benefits),
- the nature of with-profits business (as displayed in factors such as the application of smoothing, the grouping of policies of different ages and policy sizes, and the bonus mechanism), or
- the impact of investment market movements.

For example, the value of guaranteed minimum benefits on certain policy types (in particular, CWP pensions) currently exceeds the asset share by a considerable margin and as a result, the actual payouts are significantly higher than the general target levels of payouts as a percentage of asset share.

For Esitran policies, terminal bonuses have been set so that the maturity values target 100% of asset share at maturity date where the asset share allows for the cost of providing guaranteed annuity benefits. However, if targeting 90% of asset share at maturity date ignoring the cost of providing guaranteed annuity benefits produces a higher terminal bonus rate then this rate is applied.

In addition, because of the application of smoothing, at any particular time the actual payout for a policy may be higher or lower than the average target level. Our approach to smoothing is described in more detail on page 17.

Illustrations we provide of future benefits reflect the grouping of policies that we apply and so reflect how the pay-out might be positioned within the target range.

An individual pay-out may be outside of the range, for example when there's been a significant contract alteration, or if the contract is significantly different to the average contract which is used to set bonus rates. When this happens, we consider whether the outcome is fair by taking account of whether the contract has worked as designed, and the effect of alterations and charges on the policy.

### Application of bonus scales

The actual level of maturity payouts for individual policies will be managed using the annual (including interim) and terminal bonus scales.

Bonus scales apply across groups of policies; for example, bonus scales on endowment policies may be based on all policies with a policy term within a given range, regardless of policy size. This means that although at any particular time we aim to make claim payments for each group of policies as a target percentage of asset share on average (and at least as high as any guaranteed minimum amounts), payouts for individual policies may not be equal to the target percentage.

### Factors influencing maturity payout levels

The main factors are

- the level of assets available in the **Fund** as a whole. This depends on the investment returns achieved in the **Fund**, and this in turn depends on the investment strategies within the fund. Investment strategies must take account of the underlying level of guarantees, and a more cautious strategy will generally be applied when the level of guarantees is higher (relative to asset shares) in order to protect the financial position of the **Fund** as a whole,
- the degree of smoothing being applied and
- the level of any underlying guarantees (e.g. the sum assured plus bonuses on CWP policies or the nominal unit fund on UWP policies).

As these are interconnected we'll take all of them into account when determining the appropriate level of payouts.

Under current economic conditions, the cost of meeting the underlying guarantees is a major factor, and is likely to continue to be for the foreseeable future.

The exposure to the changeable cost of honouring guaranteed annuity options on certain pensions policies is mitigated to a significant extent by investing in fixed interest securities of an appropriate duration. We may also mitigate this risk

using a derivative hedging program. Nevertheless, on certain policy types the value of the guaranteed benefits exceeds the asset shares by a substantial amount.

There are a number of other factors which affect the level of surplus arising in the **Fund** and in turn the level of assets available to support payouts. These include the level and rate of incidence of death and critical illness claims, surrender profits and losses, the level of expenses charged to the **Fund** and taxation. Generally, such factors will have a smaller impact on the **Fund** than the overall investment return, although we do monitor this regularly and take steps, where appropriate, to manage their impact to minimise any adverse impact on the fund.

## Amounts payable on surrender

### Surrender values

#### CWP policies

- For **life policies**, these are targeted as a percentage of asset shares and we're currently targeting an average of 100% of asset share.
- For **pensions policies**, these are normally derived from recalculation of the policy benefits from inception, as if the policy had been written originally for the term at which surrender is being requested. On **group deferred annuity pension schemes** the surrender value may be further reduced by the application of a MVR.
- For **group deferred annuity pension schemes** (including executive schemes and Esitran policies), the value paid on late retirement is the maturity value plus interest from the retirement date stated in the contract until the date on which the benefits are taken.

For life policies, we expect payouts on surrender to be, on average, in line with a percentage target level of asset shares across the business in the **Fund** and we're currently targeting 100% of asset share. For pension policies, we expect payouts on surrender to be, on average, no less than 100% of asset share, although the method used currently results in surrender values which are higher than 100% of asset share.

The surrender value bases are reviewed at each bonus declaration to ensure they're consistent with the above objectives.

Surrender values aren't guaranteed.

### Surrender values close to maturity

The Company may smooth the surrender value towards the then current maturity value for policies of similar type and similar duration in force. When this is done, it is achieved using appropriate parameters in the surrender value formulae described above.

#### UWP policies other than those investing in Series 1



The amount of final bonus applied on surrender works the same as for final bonus paid on maturity.

Currently, we expect payouts on surrender to be, on average, in line with a percentage target level of asset shares across the business in the **Fund** and we're currently targeting 100% of asset share.

We don't guarantee to pay any minimum surrender value on UWP policies, and terminal bonus and MVR levels can be varied at our discretion.

### Surrender values close to Guaranteed Dates (where no MVR applies)

Surrender payouts are calculated consistently and without adjustment if they are made near to Guarantee Dates so, where an MVR is being applied, the surrender value before and after a Guarantee Date could be significantly different to the value at the Guarantee Date.

### Factors influencing surrender values

The main factors are the same as those affecting maturity payout levels, i.e. the values of the with-profits fund and asset share associated with each policy, the level of available assets in the **Fund** as a whole, the degree of smoothing being applied and the level of underlying guarantees.

Final bonuses and, for UWP policies, MVRs on surrender are kept under regular review, and the scales may change several times a year in response to changing market conditions.

### Use of target ranges for surrenders

Our target is for at least 90% of surrender payouts to be between 80% and 120% of unsmoothed asset share – excluding policies where the guaranteed minimum payout exceeds the underlying asset share. Bearing in mind the benefits customers can gain from smoothing, we consider that the range is appropriate and fair.

We regularly assess whether we're meeting this target by comparing the unsmoothed asset share of each surrendering policy to its surrender value. Any application of final bonus or MVR is determined based on analysis of policies within

each product group and UWP unit series by comparing combined asset shares and surrender values.

In practice it may not be possible to achieve payouts that always meet this target as a percentage of asset shares for the same reasons as noted for maturities.

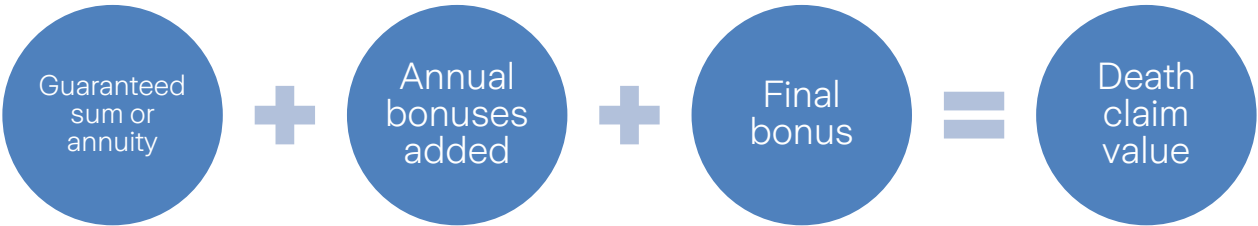
Illustrations we provide of future benefits reflect the grouping of policies that we apply and so reflect how the pay-out might be positioned within the target range.

An individual pay-out may be outside of the range, for example when there's been a significant contract alteration, or if the contract is significantly different to the average contract which is used to set bonus rates. When this happens, we consider whether the outcome is fair by taking account of whether the contract has worked as designed, and the effect of alterations and charges on the policy.

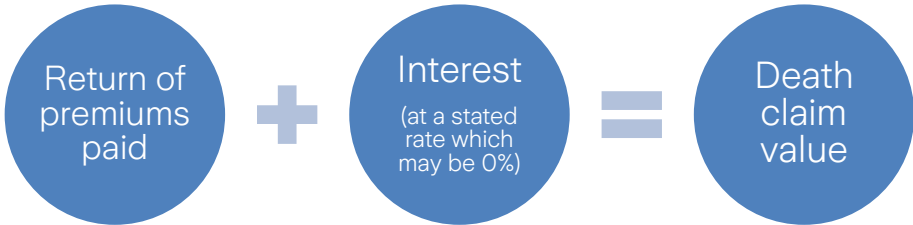
Amounts payable on death claims

The amounts payable on death claims depend on the contractual terms of each policy type but typically will be calculated using 1 or more of the following (in some cases taking the highest of the values under each method):

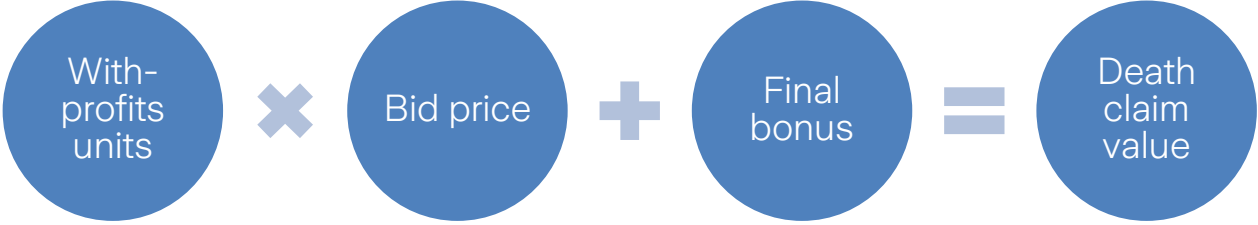
CWP policies



or (commonly for pension plans)



UWP policies other than those investing in Series 1



or, for either type of plan, where stated in the policy conditions a

Guaranteed minimum sum assured

For some pensions policies (in particular, group pensions), no benefit may be payable on death.

Some policies also have additional or optional benefits such as accidental death cover, waiver of premium benefit, and claim amounts on such benefits will be as defined in the policy conditions.

Series 1 UWP policies

Amounts payable on surrender or death claim are described above under maturities.

Documentation of methodology and assumptions

We keep detailed records of the methods and assumptions used in the calculation of claim values, along with the systems used to implement them and consider these records are suitable for the purpose of documenting how claim amounts in general are derived.

# Bonus policy

**In summary**, the level of any bonus or MVR depends on the investment surplus made in the fund over time so if insufficient surplus is made then bonuses could be zero.

## Annual bonus

- added regularly
  - as a percentage of the Guaranteed Amount and previously added bonuses for CWP.
  - through increases in the price used to value the with-profits units for UWP.
- no guarantee one will apply each year but once added they're a guaranteed part of the policy benefits providing it continues to its Guarantee Date.
- annual bonus rates declared apply to all policies within each series – however, different rates may be applied to life and pension policies to take account of different tax treatment.)

## Final bonus

(also known as terminal bonus)

- added at date of a claim using a table of rates that are reviewed regularly.
- added to reflect the actual experience of different groups of policies in the **Fund** over the lifetime of each policy.
- no guarantee a bonus will apply and the amount of bonus added may change at any time.

For plans where no final bonus is currently being paid, we don't expect to introduce them for the foreseeable future.

## Market Value Reduction (MVR)

- applied on certain types of claims when the assets supporting the with-profits units fall below their nominal value.
- where in line with policy terms and conditions, we guarantee not to apply an MVR in certain circumstances or on certain dates (Guarantee Date). The amount paid on a Guarantee Date will be at least the value of any with-profits units cancelled to meet the cost of the claim.
- If the MVR is less than £10 or less than 0.5% of the nominal unit value for a full claim it won't be applied. For partial claims this threshold is reduced pro rata by the amount withdrawn compared to the nominal unit value of the policy before that withdrawal. For plans that are made up of individual policies the £10 threshold applies over the total value of all of those policies held.

## Principles

- Bonus rates will be determined by the Board with advice from the With-Profits Actuary.
- Annual bonus rates will be reviewed regularly by ZAL and updated when appropriate. A formal declaration of annual bonus rates will be made at least once in each calendar year. Different rates may be declared for groups of policies in different bonus or unit series to reflect the different characteristics of those policies and each bonus or unit series in a way which we consider to be fair for all customers.
- Annual bonus rates for different bonus or unit series will be set so they progress towards the levels which we believe to be sustainable in the medium to long term, consistent with sound and prudent management of the **Fund** as a whole. While we'll aim to ensure a smooth progression of annual bonus rates from year to year, there are no constraints on the level of change in bonus rates that may apply and where insufficient investment surplus exists annual bonus rates may be zero.
- Final bonuses and MVRs will reflect the difference between the target level of payouts and the guaranteed minimum value payable on maturity, so both may be zero (and possibly for long periods). As a result of smoothing, and the need to manage the financial resources of the **Fund** in a sound and prudent manner, changes in final bonuses and MVRs won't necessarily precisely reflect the recent performance of the **Fund**.

## Practice

### Bonus Series

**CWP business** is classified into separate **bonus series** and bonus rates declared apply to all policies in that series.

The different bonus series reflect variations in the underlying policy types, such as the tax treatment, the form of benefits paid and the nature of the guarantees attaching to the policy.

**UWP business** is classified into a number of **unit series**, depending on the policy type and when it was written.

Different annual bonus rates may apply to different unit series, for example to reflect different contract structures or to reflect the different tax treatment of life and pension contracts.

A summary of the practices relating to overseas-type business can be found in Appendix C.

## Annual Bonuses (including Interim Bonuses)

### Application of annual bonuses

#### CWP policies

- These are declared as a percentage of the guaranteed amount (or paid-up pension) and any previously added annual bonuses.
- The rate of bonus usually differs for different policy types, and the rate applied to the guaranteed amount may be different from the rate applied to previously added annual bonuses.
- Annual bonuses are added at the end of a calendar year (or, in the case of group deferred annuity contracts, on the following scheme anniversary).
- Interim bonuses may be applied on claims made between declarations of annual bonuses to reflect some or all of the potential annual bonus accrual in the interim period, but these are not guaranteed.
  - Rates are declared at each bonus declaration and are commonly the same as the annual rate declared for the same bonus series. Where we've determined we may need to change future bonus rates, some or all of this change may be reflected in interim bonus rates declared.

#### UWP policies

- These are added in the form of daily increases in the price of with-profits units.
- The rate of increase is declared in advance - usually on an annual basis (although it can be changed more frequently).
- For most series of with-profits units, there's a guaranteed minimum bonus rate (which may be zero, i.e. the unit price cannot fall) and the bonus declared reflects the rate of increase over and above the minimum rate – both the minimum rate and the bonus rate vary by unit series.
- The exception is [Series 1 units](#), where the guaranteed minimum bonus rate applies to the guaranteed unit price rather than the bid price.

### Approach to determining annual bonus rates

Our objective is to develop annual bonus rates that we believe to be sustainable in the medium to long term, with the rates declared for any year reflecting a progression towards the long-term rates. In making this assessment, we

- take account of trends in recent economic experience and the expected future investment return on the assets notionally allocated to each of the policy groups in the [Fund](#) and
- pay close attention to the need to meet customers' guaranteed benefits, both now and in the future. On some policy types, the value of guaranteed benefits is currently significantly more than the aggregate asset shares – in such cases, no terminal bonus is payable, and current and future annual bonus rates may be set at a low level or may be zero.

As part of the process for determining these rates, we consider the current and projected financial position of the [Fund](#) using financial projections based on what we consider to be realistic assumptions for future experience in respect of factors such as investment returns, expenses, surrender rates, mortality and tax. From this, a range of possible bonus rates is established.

Based on these investigations, annual bonus rates are set at cautious, affordable levels. If the eventual outcome means that a higher level of bonus could've been paid, any excess is available to be used towards final bonus or to support the Estate.

Similarly, we may apply part of the Estate to provide temporary support to bonus levels if the eventual outcome is less than expected. We don't apply any specific rules relating the levels of annual bonus to the rates of returns on particular asset classes.

### Frequency of review of rates

For both [CWP & UWP policies](#) rates are normally reviewed annually, but we may review them more frequently and will inform customers of any change. As the fund is closed, and will continue to reduce in size, it may become necessary to change bonus rates more than once a year.

Interim bonus rates for [CWP policies](#) are also reviewed at least annually and may be changed (including being set to zero) at any time.

### Changes in annual bonus rates from year to year

We aim to change the rates declared by no more than 1.5%, however in extreme adverse conditions larger changes may need to be applied, and annual bonuses could be reduced or suspended if we consider it necessary to ensure that the overarching principle of ensuring policyholders' guaranteed benefits can be met.



## Bonus scales

We aim to keep the number of different bonus scales at a manageable level but retain the discretion to create new UWP bonus series and apply different scales to different groups of policyholders. This is to maintain fairness between the different groups, and will take account of factors such as:

- the type and level of charges built into the premium basis for policies in each series,
- the assumed underlying investment mix (which may vary for different groups of policies. For example, it's different for UK-type and overseas-type policies),
- any guaranteed levels of unit growth, and
- the current balance between asset shares and the value of guaranteed benefits.

### Minimum unit growth rates

UWP unit series	Life policies	Pension policies
Series 2 & 7	3% annually	4% annually
Series 2a & 2b	0.75% annually	1% annually
All others (except Series 1)	0%	0%

The annual bonus rates declared represent growth over and above the minimum rate, but it is possible that bonuses could be zero, in which case only the minimum unit growth rate applies.

## Final bonuses and MVRs

### Application of final bonuses

#### CWP policies

These are expressed for most contracts as a percentage of the total bonuses previously added up to the date of the claim, although for some group deferred annuity contracts they're expressed as an addition to the total maturity benefits.

The rate will depend on the policy type, and typically vary based on

- the calendar year the policy, or any premium increment, became eligible to participate in the profits of the **Fund** or
- the period since the policy, or premium increment, first became eligible to participate in the profits of the **Fund**.

#### UWP policies

These become eligible for final bonuses once with-profits units have been held continuously for specified lengths of time and will be expressed as a percentage of the nominal value of the units allocated to a policy at the date of the claim.

Specific rates of final bonus may apply to different policy types and within each unit series for each product the same rate applies. For this reason, we may create new UWP bonus series to maintain fairness between units purchased at different times.

### Approach to determining final bonus rates

Final bonus rates are generally reviewed in detail on an annual basis once any proposed changes to annual and interim bonus rates have been determined. However, they may be changed at any time to reflect current investment conditions.

We determine them by considering current or projected asset shares on what we consider to be a realistic basis, taking account of the target payouts as a percentage of asset shares and any underlying guaranteed amounts (including bonuses previously added).

The results of these projections are considered across groups of similar products and policies to develop an unadjusted final bonus scale, to which smoothing is applied.

Under normal circumstances we aim to set final bonus scales so the amount by which maturity payouts on identical representative policies would change in successive years is in the range of plus or minus 15%.

However, larger differences may apply in periods of very adverse investment performance or when the financial circumstances of the **Fund** are otherwise weak.

The change in final bonus rates on single premium policies may be larger than on regular premium policies, as the impact of different investment returns, based on the period since the single premium was paid, will generally be greater.

There may be some individual policies that change by more than 15% between successive years. On average however, the maturity payouts for individual policies are aimed to vary by less than this in successive years.

The target for setting final bonuses on Esitran policies is as described for maturities.

In making these decisions, discretion is exercised by the Board, with the advice of the With-Profits Actuary and taking into account the target levels of payouts.

### Market Value Reductions (MVRs)

The objective in applying an MVR is to ensure payouts are in line with the target percentage of the asset shares to protect the interests of continuing policyholders in the **Fund**.

The rate of any MVR applying can be varied frequently.

The rate may be different for different policy types and unit series, and can vary based on the length of time the policy, or 15



premium increment, has been invested in the [Fund](#).

#### [Approximations used in calculating bonus rates](#)

As described earlier, approximations are used in calculating bonus rates. The most significant appear in the projections we use to assess sustainable bonus rates, where future experience assumptions used in the projections are estimates.

For determining the bonus rates declared, each policy is assigned into a group determined by its product type, unit series, year of entry and policy term.

Our estimates of future experience in respect of expenses, surrender rates, mortality and tax, etc, will be based on analyses of our recent experience in these areas, taking appropriate account of any known factors which are likely to change the position going forward. The estimates of future investment returns will be based on our view of investment markets at the time and take into account the investment strategies expected to apply to various groups of policies.

For some policy types, where full histories of information on premiums paid aren't readily available, approximations are used.

The less variation there's been in the level of premiums, the easier it is generally to derive bonus rates which reflect the actual contributions of different policies to the [Fund](#).

On most regular premium life policies, where such variations are linked mainly to reviews on mortgage-related endowments, the degree of approximation is relatively small, and it's possible to model most of the business for the purposes of setting bonus rates.

On the other hand, for some classes of pensions business, there may be considerable variation in the level of premiums paid over the years – making the degree of approximation higher, and a lower proportion of business is used for setting bonus rates.

# Smoothing

**In summary**, ZAL regards smoothing as a normal part of the operation of with-profits business. It applies smoothing to policy benefits in the **Fund**, to reduce the impact of short-term fluctuations in asset values on claim payments by means of the bonus mechanism and, in particular, by using a smoothing formula to change the levels of final bonuses and MVRs.

We won't always be able to apply smoothing as the degree to which we can reasonably apply smoothing depends on the available financial resources of the **Fund**, and in adverse circumstances we may substantially amend our smoothing criteria, or substantially reduce the degree of smoothing, in respect of certain (or all) groups of policies.

A summary of the practices relating to overseas-type business can be found in Appendix C.

## Principles

- Smoothing will be applied to payouts through operation of the bonus mechanism subject to the overriding constraint of maintaining adequacy of financial resources of the **Fund** so that they're sufficient to meet the payment of guaranteed benefits.
- In exceptional circumstances, we may apply less smoothing than we'd typically expect to provide for fair treatment of all customers.
- Our objective is to ensure that the impact of smoothing is neutral over the medium to long term, and the term over which smoothing operates could be several years.
- The degree of smoothing on surrenders may be less than on maturities and other types of claim, and on single premium policies it may be less than on regular premium policies

## Practices

### Types of smoothing

#### Smoothing within groups of policies

As noted under 'Bonus Policy', the same bonus rates are applied to similar policies within a group of policies regardless of, for example, the age of the policyholder, the policy size or the exact issue date within a calendar year. Consequently, the actual payout will not be exactly the same as the target percentage of asset share for all policies within the group, but rather the target will reflect the average characteristics of the group as a whole.

#### Smoothing across groups of policies

Approximate bonus rates will be set for groups of policies with similar characteristics and for different groups of policies of the same type but with different terms or durations.

We aim to smooth the payouts across the whole group of policies and adjust the approximate bonus rates accordingly in arriving at a final bonus scale. For example, we may consider groups of policies with similar durations in force maturing in a given year when determining bonus rates.

#### Smoothing where there are guarantees

In the same bonus series, smoothing will be applied in the same way regardless of whether a policy has a guarantee.

#### Smoothing from period to period

Asset shares will largely reflect investment conditions, but we aim to manage payouts such that the difference in the maturity values of similar policies maturing in successive years is within a given range, as noted above.

As a result, payout levels may, from time to time, be outside of the target percentages of asset shares described above. When this happens, we aim to smooth average payouts back into line with these targets over a small number of years, along what we refer to as a "glidepath". The glidepath isn't fixed and will be adjusted each year in response to actual experience, and, in particular, to investment performance. Any profit or loss in the **Fund** as the result of applying the glidepath will be reflected in the Estate and be taken into account when considering changes in the target percentage of asset shares paid out on claims in the future.

#### Smoothing of annual bonus rates

We aim to set annual bonus rates consistently with current investment conditions, taking account of long-term sustainable rates, although we don't apply any specific rules relating bonus levels to the returns on particular types of assets.

However, where a change in current bonus rates is considered necessary, we aim to limit the amount of change year on year to smooth bonus rates up or down towards the long-term rates we consider to be appropriate.

### Current smoothing criteria

We determine the amount of smoothing for a particular group of policies by reference to:

- the absolute percentage change in payouts over the period on similar policies,
- the investment performance over the period of the assets in the **Fund** notionally allocated to that group of policies, and
- the change in the ratio of asset shares to payouts over the period.

Our aim is to smooth maturity and death payouts so the difference in values of payouts on similar policies, in successive years, is in the range of plus or minus 15%. As described in 'Bonus Policy', this applies for groups of policies as a whole, there can be greater variation at the level of individual policies and the range is likely to be larger for single premium policies than regular premium policies.

In adverse circumstances, a wider range may be applied.

### Limits on smoothing

Our ability to apply smoothing depends on the available financial resources of the **Fund** and, in adverse economic conditions, it may be limited to protect the overall financial condition of the **Fund**.

Smoothing may also be limited in circumstances where guaranteed payouts have become substantially greater than the target percentages of asset shares. Under such circumstances, we believe it's not appropriate to apply smoothing to payouts on such policies, as this could adversely affect the financial condition of the Fund and unfairly damage the prospects for other groups of policyholders. This may mean that payouts for such policies reduce in value to, or near to, the minimum guaranteed amounts relatively quickly.

### Differences in smoothing by policy type and claim type

Generally, smoothing is applied in a consistent manner across all policy types and between different generations of policyholders. The degree of smoothing may vary for different classes of business to reflect factors such as the mix of assets associated with each group of policies and whether they're single premium or regular premium.

The degree to which smoothing is applied also varies based on claim type, and to some extent to policy type. Typically a greater degree of smoothing may be applied to maturity and death claims, to the extent the payout isn't dictated by any guaranteed minimum level of benefits.

As noted in 'Amounts payable on claims', less smoothing is applied in respect of Series 1 UWP units due to the pricing structure of those units.

For surrenders on CWP business, claims closer to maturity may be smoothed more than claims that happen earlier in the policy term.

### Partial withdrawals where no MVR is applied

Some investment contracts allow for regular partial withdrawals, up to a limit stated in policy conditions, to be taken without an MVR being applied. This MVR isn't then recouped from future payments from the policy.

# Investment strategy

**In summary**, ZAL holds a mix of investments to support the business in the **Fund**, including equity-type assets (such as UK and overseas shares and property) and fixed interest type assets (such as Government bonds). We may change the mix of assets or use different assets in line with our overall investment strategy.

The overall investment strategy is set with the aim of ensuring adequate resources are available within the **Fund**, to meet at least the guaranteed level of benefits, using a suitable portfolio of assets with an acceptable level of risk.

Within this overall framework, we allocate different asset mixes to UK-type and overseas-type business. We also notionally apply different mixes of assets to different groups of policies to take account of factors such as the

- average term to the next Guarantee Date and
- level and type of the underlying guarantees.

A summary of the practices relating to overseas-type business can be found in Appendix C.

## Principles

- Investment policy for the **Fund** is the responsibility of the Asset/Liability Management Investment Committee (ALMIC), subject to the powers reserved by the ZAL Board in respect of setting of investment strategy and approval of with-profits fund strategies.

The ALMIC sets the policy with advice from the Investment Managers, the Chief Financial Officer (CFO), ZAL's Actuarial Function and the With-Profits Actuary and will refer any major proposals in relation to investment strategy to the Board for approval.

- The investment strategy of the **Fund** will be set taking account of (in order of priority):
  - the current and projected financial position of the **Fund** and the need to ensure the adequacy of the available financial resources within it,
  - the level and incidence of guarantees in respect of the business of the **Fund**, and
  - the reasonable investment expectations of all classes of policyholder, based on information provided to them, the evolution of investment markets and the financial strength of the **Fund**.
- Risk will be managed through

selection of assets, including derivatives, of appropriate quality

- setting limits on the amount of
  - any one asset held or
  - exposure to any given 3rd party.

These criteria will be determined by the ALMIC and followed, so far as is reasonably practicable, by the Investment Managers.

- Certain assets may be notionally allocated to different sub-groups of policies within the **Fund** where the ALMIC deems it appropriate to reflect the type, extent and timing of guarantees, or any other significant differences in the underlying nature of the sub-groups. The investment strategy in respect of such assets will be determined to reflect the different requirements of the associated sub-group.

## Practice

### Investment objectives

The assets of the **Fund** are largely managed by Investment Managers, currently Threadneedle Asset Management Limited, and a portfolio of fixed interest type assets is managed by M&G Investment Management Limited. Assets backing overseas type business are managed locally in the relevant territory. Any change in Investment Managers will be determined by ALMIC as part of the investment strategy.

The current overall investment objective is to achieve above average returns in the longer term relative to market-index benchmarks agreed between the ALMIC and the Investment Managers. These benchmarks will make appropriate allowance for risk preferences, as determined by the ALMIC, taking account of the characteristics of the business in the **Fund** such as the level of guarantees and the average outstanding term.

The Investment Managers may be instructed to apply different asset types in respect of any identified sub-group of business within the **Fund**. Asset types that may be used include equity-type assets, such as UK and overseas shares and property, and fixed interest type assets such as government and corporate bonds, as well as unlisted assets and cash. The fund may also make use from of appropriate derivatives, as described below. Assets may be held either directly or via collective investment schemes.

The investment mix for assets notionally allocated to each separately identified sub-group of policies will take account of the maturity of the **Fund** and the likely amount and incidence of payouts - particularly in respect of guaranteed amounts where our ability to adjust payouts to reflect investment conditions is limited.

### Review of investment strategy

Formal reviews of the investment strategy will be held at Board level at least annually. More frequent reviews may be required following substantial changes in market conditions. In addition, we regularly monitor investment performance and quarterly meetings take place with the Investment Managers to monitor progress in respect of investment policy and

to consider any appropriate changes.

### Matching of assets and liabilities

ZAL operates a matching strategy for the assets within the **Fund** whereby certain assets are selected whose values broadly move in line with the values of some of the underlying liabilities of the **Fund** following changes in investment conditions. These liabilities include claims on maturity, death and surrender. The guaranteed benefits for these claims are typically matched by appropriate fixed interest assets.

Where the asset mix allows, matching assets are chosen to ensure that they provide appropriate patterns of income from interest and capital proceeds to meet the guaranteed benefit payments.

Other assets may be invested to include equity-type assets with the aim of achieving a higher investment return consistent with the principles set out above.

Liabilities in respect of guaranteed annuity rates are matched by fixed interest investments and the exposure to these guarantees may also be mitigated by an associated derivative hedging program.

### Investment in different asset classes

Based on the mix of guaranteed and non-guaranteed liabilities in the **Fund**, the nature of the underlying policies (in particular, the extent to which policyholder benefits depend on certain levels of investment performance), and the overall investment strategy, we set benchmarks for the investment mixes of the assets backing policies within the **Fund**. These benchmarks also specify, in broad terms, the mix between short-term, medium-term and long-term fixed interest investments. Different benchmarks apply for UK-type and overseas-type business.

The benchmarks for UK-type business are currently set by considering the level of guarantees and the average outstanding term to the next guarantee date for different policy groups within the **Fund**. These benchmarks are reviewed periodically in response to substantial changes in the investment conditions and the Investment Managers are required to manage the assets within the specific limits defined by these benchmarks.

The Investment Managers are also required to hold an appropriate range of investments within each asset class, for reasons of security and diversification. The Investment Managers will normally only invest in assets of a quality consistent with the benchmarks. The current criteria are that gilts can be held without restriction and that, for other fixed interest assets, investment is only allowed in individual bonds that have an investment grade credit rating.

In addition, various constraints are placed on the Investment Managers to ensure the portfolio consists of a diverse range of fixed income assets and to ensure credit risk is kept within an acceptable range compared to the market. However, we may continue to hold investments in the **Fund** whose security ratings have fallen to some extent, to avoid crystallising losses unnecessarily. We may also hold a small exposure to sub-investment grade if the assets are held via collective investment schemes. The ALMIC may change the above rating criteria if it believes it's in the interests of customers in the **Fund**.

While the investment benchmarks include specific criteria for liquidity, we believe these are comfortably met as the assets in the **Fund** include a substantial amount of fixed interest securities, including government bonds, which are intended to provide liquidity to meet surrenders and contractual liabilities as they fall due.

Investment Managers may be permitted to seek additional yield on government securities through their sale and repurchase and through investing the proceeds in other assets including variable-rate asset-backed securities. This activity is restricted to only a proportion of the government securities held and is subject to credit and diversification constraints.

### Asset mix

In the past, we've invested a significant part of the assets of the **Fund** in equities and property, to achieve above average returns over the long term compared to fixed interest securities. However, it's not always appropriate to hold this significant proportion of equity-type assets due to

- their volatility,
- the prevailing market conditions at different points in time,
- the fact that the **Fund** is closed to new business with groups of policies approaching non-MVR Guarantee Dates,
- the need to hold appropriate technical provisions, and
- the need to protect the financial condition of the **Fund**.

Separate asset mixes may be used for identified groups of policies to reflect the level of guarantees and the average outstanding term to the next Guarantee Date. The assets notionally allocated to a group of policies may consist of a mix of equity type assets, fixed and variable interest type assets, and cash – with the investment return credited to each group of policies determined by the assets notionally allocated to it.

In general, a higher proportion of fixed and variable interest type assets, and so a lower proportion of property and equity type assets, may be notionally allocated to groups of policies with relatively high levels of guarantees and/or a short average outstanding duration to the next guarantee date. An appropriate degree of liquidity will be maintained for each notional pool of assets reflecting the characteristics of the associated policies. We currently use five asset mixes for the fund – three for UK-type business and a further asset mix for each of the Hong Kong and Isle of Man business.

For some policy groups where the current value of their guaranteed benefits exceed their asset shares, we invest entirely in fixed and variable interest type investments. We allocate part of the Estate to these groups to compensate for the possibility that future long term returns might then be less than the returns would've been if investment in equity and property type investments been retained. The allocation is made by making an annual percentage addition to asset shares.

This results in an increase to the claims paid for policy groups whose enhanced asset shares at the date of claim exceed their guaranteed benefits. The current excess of the value of guaranteed benefits over asset shares means this is only likely for a small number of policy groups. The percentage allocation rate is set at the time the investment strategy is determined and doesn't depend on the actual returns achieved.

We'll aim to avoid abrupt changes in the investment mix but may decide to move quickly into appropriate fixed interest investments in response to adverse market movements or to protect the financial condition of the **Fund**.

We update customers about the asset mix at least annually.

### Sustainable investment and climate risk

We aim to be a responsible and impactful business striving for a positive impact on society and our planet. This extends to how the Investment Manager selects the companies they choose to invest in on our behalf. The management of Environmental, Social and Governance (ESG) risk including climate risk is a key part of this.

In managing the assets of the **Fund**, the primary investment objective is to achieve above average returns in the longer term relative to market-index benchmarks agreed between the ALMIC and Investment Managers. Sustainability, ESG and climate related risks and opportunities are considered, and Investment Managers consider a wide range of ESG factors when making investment decisions.

The Fund isn't managed primarily on sustainability grounds but when investing we look at ESG factors which drive risk, reputation, and long-term success of the firms in which we invest.

### Use of new types of investments

Unless covered specifically in the investment benchmarks, the use of new types of investments is not normally permitted without specific approval of the ALMIC.

### Non-tradable assets

The **Fund** doesn't have any significant holdings of non-traded investments and any proposal to invest in non-traded investments to any substantial extent requires the approval of the ALMIC.

ZAL itself has a number of subsidiary companies. These form part of the assets of the NP Fund and the SH Fund, and the **Fund** therefore has no interest in any profits (or losses) from these companies.

### Use of Derivatives

The ALMIC may instruct the Investment Managers to consider the use of derivatives.

#### What are derivatives?

- financial contracts which give the holder the right to exercise a defined option to buy or sell assets at a particular price and a particular time.
- examples include "put and call options", interest rate swaps and foreign currency futures.
- their value lies in the benefit of the certainty of the price they can be bought and sold at to offset the risk that an asset's price rises or falls – which would otherwise mean selling at a loss or buying at a higher price. This makes them useful for protecting the **Fund** against adverse movements in asset values or yields, but equally they can restrict the benefit to the **Fund** of significantly positive asset value changes

#### How are they used?

- may be purchased within the **Fund** as part of efficient portfolio management to effect switches between equity-type and fixed interest-type assets - providing some protection to asset shares against adverse market movements or provide a lower-risk opportunity to benefit from positive market movements.
- may be purchased within the Estate, which is sensitive to changes in the cost of providing customer guarantees, to protect it against changes in investment conditions.

The current criteria for their use is that the counterparties to derivative contracts must provide appropriate security and must be group approved counterparties – however, we may continue to hold existing derivatives even if these criteria are no longer met. Changes to the criteria may be agreed by the ALMIC if it believes that it would be in the interests of customers in the **Fund**.

**How it works in practice:**

The **Fund** may hold derivatives that protect it against falling equity values by allowing it to

- buy 'put options' and
- sell 'call options' at the same time.

This strategy may have an initial cost depending on the strike prices chosen for the put and call options. The higher the strike price for the call option, the higher the initial cost but also the higher the potential investment return from equities held.

This combination of a put and call option sells the upside above a given level (the strike price of the call option) in exchange for providing protection below another level (the strike price of the put option). The **Fund** is therefore protected if equity markets fall by holding put options but the potential growth, if equity prices rise significantly, is limited by issuing call options.

The **Fund** may also buy put options without selling call options at the same time. This strategy always has an initial cost, but, apart from this, doesn't limit the potential return from equities held in a rising stock market.

The option strategy adopted will be determined each year based on prevailing market conditions and investment advice received. Both strategies reduce the volatility of equity returns.

We'll update customers on these holdings as any significant changes happen.



# Exposure to business risk

## Principles

- The Board will aim to manage risks in relation to the business of ZAL and the **Fund** through regular monitoring of risks and by promptly taking appropriate actions to reduce inappropriate risk exposure.
- Other than in respect of normal levels of investment risk resulting from the management of the assets of the fund, no new risks of a material nature will be taken on by the **Fund**. In particular, the **Fund** is closed to all new business except for contractual increments to existing policies.

## Practice

### Risk management structure

Risk management is one of the key responsibilities of the Board and they manage risk through their planning and operational strategies, and by collection and use of appropriate management information.

Day-to-day management of the major risk factors affecting the business is the responsibility of the different business units within ZAL. These business units are also responsible for identifying any new risks which emerge, and which may become significant.

A Risk Committee of the Board has been established to monitor ZAL's risk management processes and advise the Board accordingly. The Committee reports to the Board at least quarterly and more frequently if required.

Techniques used to manage risk include

- changes in investment strategy,
- use of reinsurance or derivatives to provide appropriate hedging, and
- securing the services of suitably qualified resources to manage the business (including, if the Board feels appropriate, through the outsourcing of administrative or technical work to 3<sup>rd</sup> parties).

### Major risks

The most significant risks identified for the business of the **Fund** are set out below, along with the actions that've been taken to mitigate them. As the business in the **Fund** matures, and as the external environment changes, different risks may be identified in the future, or the risks described may reduce in importance.

Each of the risks described can influence the amount and timing of the investment surplus that emerges in the **Fund** or the amount of any charges that we levy on the policies in the **Fund**. The maintenance of adequate financial resources within the **Fund** is considered paramount, and appropriate action will be taken to minimise the potential impact of these risks on the **Fund**.

#### Longevity risks and guaranteed annuity options

Much of our pensions business includes options to take benefits as an annuity at maturity with some CWP pensions including a contractual guarantee of a minimum annuity rate. These guarantees impose risks on the **Fund** in that the cost of the guarantees increases with improvements in longevity of annuitants and with reductions in interest rates.

We have set up explicit technical provisions to allow for the cost of these guarantees. We regularly monitor these, and the associated mortality assumptions, and review investment strategy to limit the exposure to changes in market conditions.

#### Other guarantees associated with policies

Under most policies in the **Fund** there are guaranteed minimum payouts on maturity and death and surrender on certain defined events (such as Guarantee Dates when no MVR can be applied).

As annual bonus additions are applied, the underlying level of these guarantees increases. We manage this by limiting the buildup of these guarantees - for example, by applying annual bonus rates we believe can be adequately supported by the financial resources of the **Fund**. We also maintain explicit technical provisions within the **Fund** appropriate to the types and levels of the different guarantees.

#### Investment risks

The investment risks most relevant for the business of the **Fund** are likely to be

- falls in equity/ property values,
- changes in fixed interest yields,
- defaults on fixed interest and variable yield securities, and
- liquidity constraints.

Investment losses reduce the funds available to meet the guaranteed minimum benefits referred to above.

We attempt to manage these risks through the investment strategies described above, including

- matching liabilities with fixed interest assets of appropriate term,
- investing only in corporate bonds of appropriate quality,
- managing the balance between the fund's exposure to equities and property, and investment in fixed interest assets, in a way we consider appropriate to support the levels of guaranteed benefits in the business, and
- maintaining sufficient levels of alternative liquid assets.

The asset mix may be set separately for identified groups of policies to reflect their level of guarantees and the average

outstanding term to the next guarantee date.

As noted above, to manage investment risk and protect the security of policyholder benefits, a higher proportion of fixed and variable interest type assets, and hence a lower proportion of property and equity type assets, may be notionally allocated to groups of policies with relatively high levels of guarantees and/or a short average outstanding duration to the next guarantee date.

Most of the investment management activities relating to the **Fund** are carried out by Investment Managers appointed by ZAL. These activities are managed by formal agreements between the parties, supported by regular meetings and dialogue, and monitored regularly by the ALMIC.

#### Miscellaneous business risks affecting the with- profits business

Miscellaneous risks affecting policies in the **Fund** include risks related to expense levels, mortality, morbidity and taxation, as well as regulatory risk.

The expense risk is largely under the control of the Company. The scheme of arrangement which came into effect on 1st January 2005 gave additional protection to the **Fund** and we now charge a fixed amount each year, which increases in line with the Average Weekly Earnings Index, to cover servicing costs and administration costs associated with a claim. Investment fees are charged as incurred.

Expenses for Group Pension Scheme plans, and those incurred when setting up increases to existing plans, are not affected by the scheme of arrangement and continue to be charged to the **Fund**. We only allocate expenses to the **Fund** which we consider to be fair and reasonable.

The other types of risk are largely outside our control, but we've allocated explicit accountabilities to key staff to monitor and manage such risks.

#### Potential compensation claims in respect of allegations of mis-selling

We aim to ensure that management actions are consistent with sales literature and subsequent communications with customers. If any costs arise associated with mis-selling of business in the **Fund**, these will be met from the NP Fund, i.e. they'll affect shareholders' interests rather than those of customers.

#### Impact of risks on payouts

Any adverse impacts of business risks aren't applied directly to the calculation of individual policy asset shares, but instead the cost of risks is allocated to the **Fund** as a whole. We believe this to be consistent with the fundamental concepts of with-profits business.

Our ability to provide payouts, as described on page 8, depends on the overall financial strength of the **Fund**, so policies may be affected by the impact of any risks to the extent that this is affected. The impact of any adverse outcome is likely to be seen through a lower degree of smoothing and faster reductions in average payout levels, or possibly a reduction in the target ratio of payouts to asset shares. Generally, the cost of any such risk will be spread over time across different policies and generations of policies, whether making claims currently or continuing in the fund. There's no specific minimum size for any risk before it's applied in this way.

If a risk arises which relates specifically to a particular policy type or generation, it may not be fair to allocate the cost of this risk to all customers. In this case, we may apply some or all the cost of this risk to the policies in question, provided that's consistent with the policy conditions and any legal judgements.

#### Impact of external risks

Risks arising in the 100:0, the DCP or the NP Funds won't normally affect policies in the **Fund**. An exception to this might arise in the event of extreme adverse investment conditions, meaning the **Fund** needed to call upon financial support from the DCP or NP Fund (or both) at a point when, because of the impact of other risks, that fund was unable to provide that support. In those circumstances, support would need to be provided from any available resources of the SH Fund. The means of providing support to the **Fund** is described in Appendix B.

We have agreements in place that govern the services provided by the Investment Managers. The agreements may be terminated in circumstances such as where there is a material breach of the agreement or where there is gross underperformance of the fund compared to agreed investment criteria. For strategic decisions to move to other Investment Managers, the agreement can be terminated subject to appropriate notice periods being observed.

# Charges and expenses

## Principles

- All charges for administration expenses and commission applied to asset shares in respect of policies in the **Fund** will be based on what the Board, in consultation with the With-Profits Actuary, reasonably considers to be a fair apportionment of the costs incurred, including any spreading of development costs.
- The cost of investment management applied to asset shares in respect of policies in the **Fund** will be based on what the Board, in consultation with the With-Profits Actuary, reasonably considers to be a fair apportionment of the total investment management costs incurred, considering the actual asset mix and investment activity of the **Fund**.
- The Board may determine alternative strategies for the management of the business of ZAL, including consideration of 3<sup>rd</sup> party outsourcing arrangements, but attention will be given to the interests of customers of the **Fund** as well as taking account of any factors it believes to be relevant when taking such decisions.

## Practice

### Types of charges

Generally, for policies in the **Fund** costs of administration and investment management:

- ✗ **aren't** applied as specific charges defined in the policy structures, but
- ✓ **are** deducted from the accumulating asset shares - and therefore affect each policy's ultimate benefits to the extent that these are used to calculate those benefits.

The costs of providing risk benefits, such as life and/or critical illness cover, are charged to asset shares based on the estimated average cost over groups of similar policies.

To date

- the costs of certain guaranteed benefits, such as guaranteed annuity options, guaranteed maturity values and guaranteed non-MVR options, have been met from the resources of the **Fund** as a whole, and
- the impact of smoothing has also been met by the **Fund**.

which has impacted the available financial resources that can be considered when determining payout levels for all policies.

### Policies where specific charges are built into the product structure

For some UWP policies, there are explicit rates of allocation of UWP units and specific charges to allow for the costs of risk benefits, administration and investment management. These charges reduce the level of guaranteed benefits on the policies affected.

The calculation of asset shares is maintained separately, and it's the asset share (taking account of any guaranteed benefits) which informs the ultimate payouts.

### Relationship between charges and actual expenses

Our objective is to allocate expenses to the **Fund** using a fair estimate of the actual costs of administering the business of the fund.

Expenses allocated to the fund are charged to asset shares using the methods set out in Appendix A and, as a result of the scheme of arrangement (effective 1st January 2005), administration expenses

- for Group business and all investment management fees will be charged to the fund as incurred
- for all other business will be allocated to the fund on a fixed rate basis, increasing each year in line with the Average Weekly Earnings Index.

This arrangement protects the fund from increases as a result of the reducing portfolio. Although policyholders may lose some of the possible upside benefits of efficiency improvements we make, this is balanced out by removing exposure to the downside risk of escalating expenses (caused by the diseconomies of scale that can sometimes occur in a closed fund situation).

Certain UWP policies also have monthly fees deducted from units in line with policy conditions. These fees are reviewed annually and normally increase in line with the Average Weekly Earnings Index. Where investment is in both with-profits and unit linked funds, these fees are deducted in proportion to unit holdings.

### Reviews of the charging basis and of outsourced services

As noted in Appendix A, we review the charging of expenses and other costs to asset shares regularly and make appropriate changes as needed. However, we don't expect to make significant changes to this approach - except where necessary to correct any material error.

# Management of the Estate

In summary, the Estate is calculated as



The amount of the Estate

- varies according to our assessment of the cost of the future liabilities,
- can be increased or reduced by the allocation of some of the surplus or deficit or
- reduced to the extent necessary to support bonus levels.

In effect, the Estate is how we're able to provide a degree of smoothing on the business in the **Fund** and we aim to distribute the whole of the Estate over the remaining lifetime of the policies in the **Fund**, using the bonus mechanism, by enhancing asset shares at the time of the claim.

## Principles

- ZAL's objective is to ensure a fair and orderly distribution of all the assets in the **Fund**, including any Estate, over the remaining lifetime of the policies in the **Fund**. In doing this, we'll consider the relative interests of policyholders and shareholders, in particular in respect of the 90:10 split of distributable surplus.
- We'll aim to manage the timing of this distribution in such a way that, at all times, the available financial resources of the **Fund** are adequate to meet the expected level of benefits, including any underlying guarantees. We'll also aim to manage the Estate considering the financial interests of the remaining policies to control, as far as possible, excessive growth in the Estate.

## Practice

### The Estate

Currently the Estate is around 25% of the total assets of the **Fund**. As we're targeting payouts as a percentage of asset shares, and the **Fund** is closed to new business, we believe it's unlikely the Estate will grow substantially in proportion to the **Fund** as a whole. The relative size of the Estate will however change to some extent because of factors such as smoothing, miscellaneous profits or losses, etc.

### Management of the Estate

The financial resources within the **Fund** available to meet payouts are finite so, to meet our objective of achieving an orderly run-off of these resources, both the assets needed to support current and future liabilities and the Estate's assets are taken into account when calculating the level of payouts on policies in the **Fund**.

We manage this by periodically considering the current and projected future position of the assets and liabilities of the **Fund**, based on what we believe are realistic assumptions for future experience. We do this by constructing a "realistic" balance sheet to compare the value of the assets with the value of the liabilities including an estimate of the underlying cost of guarantees modelled on a "market-consistent" basis. The market-consistent approach uses, where possible, the value of an exactly equivalent traded asset (including derivatives) to value a liability but where this isn't possible, liabilities are valued in such a way as to be consistent with the market value of traded assets at the valuation date. This can be interpreted as the amount of assets needed to fully hedge a given liability at the valuation date.

The key mechanisms for managing the financial resources of the **Fund**, including the Estate, are the bonus and smoothing policies, i.e. the discretionary elements that we can use to manage the level of payouts. The Estate is being distributed to customers using the final bonus, and/or MVR, mechanism by considering whether to include an enhancement within asset shares at the time of the claim.

Any enhancement to asset shares is expressed as a percentage increase to the asset share which is reviewed at each bonus declaration. The enhancement could be altered or removed entirely at any time, depending on the experience of the **Fund**, and any enhancement applies to the asset share of all UK-type policies claiming at a given time. If an enhancement is made to asset shares, claims payments may increase as a result of increased final bonus rates or reduced MVRs on UWP contracts or increased surrender values on CWP contracts.

We reserve the right to exclude any new investment into the fund after 1 January 2023 when determining any distribution of the Estate.

Essentially, we aim to set current and future payout levels so that the value of those payouts (discounted to the present day and allowing for guaranteed minimum amounts, the cost of shareholders' share of bonus distribution and any other appropriate adjustments) is approximately equal to the total financial resources of the **Fund** including the Estate. By

adopting this approach, we expect the Estate to run down to zero broadly in line with the run-off of the business - after considering the business risks faced by the **Fund**. To make allowance for risks the **Fund**'s still exposed to, the enhancement percentage of asset shares may be lower than the percentage of total asset shares the Estate represents.

### Management of the Fund in the future

As the business in force reaches maturity and the number of policies declines, all with-profits funds face the problem of being more and more difficult to manage in a fair manner - for example, a with-profits fund depends on having a certain level of Estate to be able to apply smoothing, but it's more difficult to apply smoothing over a short term than a long term, and more difficult for a small fund rather than a large fund. There are therefore conflicts between the orderly distribution of the Estate and the maintenance of an adequate smoothing approach. The level of maintenance expenses per policy may start to increase by more than would otherwise be typical as the fund becomes smaller.

For these reasons, when the assets of the **Fund** reduce to such a size that the ZAL Board, with advice from the With-Profits Actuary, believes it's no longer in the interests of customers to continue to manage the **Fund** on a with-profits basis, the Board may elect to convert the then remaining policies in the **Fund** to a basis that consolidates any bonuses we expect to pay into a fixed benefit. This would be subject to satisfying any relevant legal and regulatory requirements in operation at the time of the proposed conversion.

In this event, we would determine fixed bonus rates so that the available assets in the **Fund** would be distributed to that business over the remaining life of the policies in force, based on reasonable assumptions determined by the With-Profits Actuary. These fixed bonus rates would take account of the relative interests of different types of policyholders and/or shareholders in a way that's fair and consistent with the approach adopted previously. The assets in the **Fund** would be invested in suitable fixed interest assets to provide an appropriate stream of income and capital to support the policy payments as they arose - and surrender value payouts would be reviewed and adjusted as considered appropriate.

### Investment strategy for the Estate

The mix of assets in the Estate takes account of the mix of assets in the **Fund** as a whole. Alternative investment strategies may be followed for the Estate if we deem this to be in the interests of the customers in the **Fund**.

### Shareholder support

Although we expect to be able to manage the **Fund**, including the Estate, so additional financial support isn't required, in adverse circumstances it may be necessary to call upon temporary or permanent financial support from the DCP, NP or SH Fund. The means for providing this support is described in Appendix B.

# Appendix A – Calculation of asset shares

## Calculation of asset shares

We use asset shares as a tool to help determine the appropriate bonus rates for different groups of policies. In broad terms, they are a measure of the contribution of policies or groups of policies to the **Fund** as a whole.

Asset shares are calculated for all policies in the **Fund** as the accumulation of:



## Asset share assumptions

The assumptions used to calculate asset shares for individual UK-type policies (including those written outside the UK but managed in the same way as UK policies) are determined as follows.

(Asset shares for overseas-type policies are determined using a similar approach with certain relatively small differences reflecting the particular nature of those policy types.)

### Investment returns

Separate pools of assets within the **Fund** are notionally allocated to support benefits for

- UK business (including Maltese business and certain other UK-type business written in the Isle of Man and Channel Islands),
- Hong Kong business and
- Overseas-type policies written in the Isle of Man.

The notional split of assets is applied for practical reasons to take account of the different nature of the policies from the different territories, although in practice all the assets of the **Fund** are available to meet all policy benefits should financial circumstances make this necessary.

For each group of policies, the total investment income, and capital gains or losses, earned from the assets notionally allocated to them is calculated as a percentage return on those assets - which is then credited to the asset shares of the policies in the group.

Investment returns for each calendar year on UK-type business are generally applied equally across that year, i.e. they don't take account of fluctuations within the year.

For UK-type business, the fund has 3 distinct asset pools with different asset mixes for identified groups of policies to reflect the level of guarantees and the average outstanding term to the next guarantee date. These pools separate the:

1. asset shares of life business, Esitran business and unitised pensions business,
2. asset shares of conventional pensions business (excluding Esitran), and
3. assets backing guarantees, options and the Estate,

and their separate asset mixes are maintained to better manage the impact of guaranteed benefits within the business and to provide better protection for the **Fund** as the business runs off.

The asset mixes within these pools vary based on the strength of the guarantees and the outstanding duration to the next major guarantee dates – and consist primarily of a mix of

- property and equity type assets,
- fixed and variable interest type assets, and
- cash.

Where:

- pools supporting policies with stronger guarantees or shorter duration have less (or no) property and equity type assets, and more fixed and variable interest type assets, and
- the average term to maturity of the fixed and variable interest type assets notionally allocated to each pool may be chosen to reflect the average outstanding duration to the dates when guarantees apply on the associated policies.

The investment return credited to any of these policy groups may be increased each year, by an allocation from the Estate, to offset the possibility that some customers could, in the longer term, be disadvantaged by such an investment policy.

Any increase will be assessed on a long-term basis and won't be dependent on the performance of the assets of the fund.

Any notional split of assets is applied solely for practical reasons, to provide better protection for the **Fund** and all assets of the **Fund** are, in practice, available to meet all policy benefits if financial circumstances make this necessary.



## Expenses and commissions

Until 31 December 2004, expense allowances were calculated for all our policies using what we considered to be a fair distribution of the total management expenses. This allocation was made using accounting techniques which are generally accepted in the UK and which took into account the nature of the expenses incurred and the relative costs of writing and administering different classes of business.

An expense allocation using this approach is performed in respect of each calendar year, and we aim to ensure any changes in the allocation are gradual.

The allowances are expressed as an amount per policy for each product type to cover the processing of new business and maintenance of existing business, and these per policy amounts are charged to policy asset shares.

For the period after 31 December 2004, on-going Investment Management Fees and expenses for Group business continue to be charged to the fund using the approach above.

On-going expense charges for individual business are made on a fixed basis increasing in line with the Average Weekly Earnings Index. These charges are calculated as an amount per policy and per claim for each product type to cover the maintenance of existing business.

Other investment costs are allowed for in the calculation of the investment returns.

For asset shares calculated from 31 December 2007, On-going expenses are charged to asset shares in line with any charges identified in the contract.

For **UWP business**, any remaining expenses and commission are charged as a proportion of asset shares up to a maximum of 2% per annum.

For **CWP business**, claims expenses are charged to policies that are claimed in the year with other remaining expenses charged as a proportion of sums assured.

Commissions on **CWP business** are allowed for at the typical average commission rates applying to each policy type at the time of their issue. These typical commission levels are based on our standard scale for the year in question, increased by the average level of commission enhancement (relative to the standard scale) that applied in practice in that year.

It's not practical to show the specific per-policy costs for all the different types of business in the **Fund**, but, to give an example, the total expenses borne by the **Fund** (from 2007 to 2023) equated to a charge of less than 0.7% of the value of the assets of the **Fund** in each year.

The charges to individual contracts may be higher or lower than this and similar level of charge on the **Fund** isn't guaranteed in the future as expenses and other costs will continue to be allocated as described above.

## Cost of risk benefits

For different classes of business, benefits payable on death, and similar claims, may be more or less than asset shares, for example:

- on most life policies, the death benefit will be substantially more than the premiums paid, but
- on some pension policies there's little or no return on death.

As a result, profits and losses will arise in the **Fund** from risk benefit claims.

We regularly assess the overall costs of providing such risk benefits and an estimated cost is built into asset share calculations by multiplying the difference between the value of the risk benefit and the asset share for that policy (the Sum at Risk) by the estimated probability the risk event might've occurred.

This estimated probability factor is based on the average experience over the year for policies of a similar type and age of policyholder.

Where overall profits or losses from these risk benefits differ from the estimated amounts applied to the asset shares, they'll increase or reduce the level of the Estate.

## Taxation

Within the sample asset share calculations for life policies

- tax is charged in respect of investment income and gains, and
- tax relief is credited in respect of expenses.

The tax rates used in each year are those that would've applied if the **Fund** had been a stand-alone business independent of our other business. The policyholder tax rate is applied to income and indexed capital gains and it's assumed there's always sufficient taxable income to relieve all expenses.

For some gains and some categories of expenses, the normal tax rules allow for spreading of tax or tax relief over a period of 7 years, and this is reflected in the asset share calculations.

No tax, or tax relief, is applied to the asset shares of pensions policies, unless there's a need to reflect unrecoverable taxes or tax credits.

The tax allocated to the **Fund** also includes tax on investment income and gains for assets over and above the total asset shares of the policies invested in the **Fund**.

Any tax liability in respect of a distribution of surplus is attributed to the Estate, so asset shares are unaffected.



Our tax calculations are carried out at a company level and any difference between the actual tax payable and the amount notionally allocated to the **Fund** through the above mechanism is met from (or credited) outside the **Fund**.

### Surrender profits or losses

Surrender profits or losses occur when the surrender values paid out differ from the asset share of the policies being surrendered.

These are calculated using actual claims data, and:

- On CWP pension policies, where the surrender value methodology results in claim values in excess of asset shares, the resulting surrender losses aren't charged to asset shares.
- For all other contracts surrender profits and losses are applied to asset shares by reducing or increasing the allowance for expenses charged in the year.

### Cost of shareholder transfers

Shareholders are entitled to receive 10% of any surplus distributed to policyholders in the form of bonuses. The cost of these shareholder transfers is allowed for in the accumulation of individual asset shares based on the bonuses allocated to the corresponding policies.

The cost of shareholder transfers is calculated using the same basis as the Best Estimate Liabilities reported in the regulatory returns except that we use the FTSE 15 year UK Gilt Index Yield instead of the valuation rate of interest whenever that yield is higher. Where this higher yield applies this'll reduce the amount of the surplus allocated to shareholders.

### Estate Distribution

The Estate is being distributed to customers using the final bonus and/or MVR mechanism by considering whether to include an enhancement within asset shares at the time of the claim. Any enhancement is expressed as a percentage increase to the asset share which is reviewed at each bonus declaration. The enhancement could be altered or removed at any time, depending on the experience of the **Fund**, and any enhancement applies to the asset share of all UK-type policies claiming at a given time. If an enhancement is made to asset shares, claims payments may increase because of increased final bonus rates or reduced MVRs on UWP contracts or increased surrender values on CWP contracts.

We reserve the right to exclude any new investment into the fund that is made after 1 January 2023 when determining and distribution of the Estate.

Essentially, we aim to set current and future payout levels so that the value of those payouts (discounted to the present day and allowing for guaranteed minimum amounts, the cost of shareholders' share of bonus distribution and any other appropriate adjustments) is approximately equal to the total financial resources of the **Fund** including the Estate. By adopting this approach, we expect the Estate to run down to zero broadly in line with the run-off of the business - after considering business risks faced by the fund.

To make allowance for the risks the **Fund's** still exposed to, the enhancement percentage of asset shares may be lower than the percentage of total asset shares the Estate represents.

### Asset share calculations

Asset shares are calculated for each policy providing the necessary historical data is available.

The calculation is carried out in monthly steps, although within that it doesn't allow for the exact incidence of any cash flows. We believe this approach doesn't introduce any material inaccuracy or distortion.

Where full historical data isn't available, and for products where there are few policies remaining, asset shares aren't calculated and the bonus rates are set to those of the most similar product for which asset shares are calculated.

### Controls and Documentation

We maintain appropriate systems for calculating asset shares and therefore claim values for policies in the **Fund**. These systems may be upgraded or replaced but we take care to ensure that any changes won't affect our ability to comply with the principles and practices set out above. Asset share assumptions in respect of more recent experience are reviewed at least annually, and more frequently if necessary.

We don't currently intend to change the asset share methodology described above other than to correct any significant errors or to make significant improvements to the calculation. We'd consider changing the methodology used in future years if new techniques were developed which became standard accepted practice in the UK life insurance industry, or if there were any relevant changes in regulations.

Assumptions for the accumulation of asset shares in the **Fund** have been determined and documented as the business progresses. We don't generally review or update these assumptions, but we'd consider making retrospective changes to them if a material error were discovered that might lead to unfairness between classes of policyholder.

Material changes to methodology and assumptions require the approval of the With-profits Actuary and if such changes are likely to have a significant impact on the amounts payable on claims, they must be approved by the Board.

# Appendix B – Financial support

## Introduction

This support mechanism was set out in the court documents relating to the scheme of arrangement effective 1 January 2005, including a non-court update effective 30 April 2017 because of the adoption of Solvency II reporting in the UK. This is a simplified description of the support mechanism of the **Fund** and the full text is available on request. Any conflict in the application of the support mechanisms will be resolved by the ZAL Board with advice from the With-Profits Actuary.

## Statutory Support

If a Statutory Deficit has arisen in the **Fund**, then a Contingent Loan for this amount will be made from the DCP, the NP or the SH Fund.

At the end of each quarter, all loans made during the period will be assessed and the **Fund** will pay the accrued interest on the loans to the Lending Fund. If by paying this interest, a new Statutory Deficit is created then a new Contingent Loan sufficient to eliminate the deficit is made.

The **Fund** will pay back any Contingent Loans but only if it doesn't create a Statutory Deficit or Realistic Deficit. The Board, with advice from the With-Profits Actuary, will decide the extent to which loan repayments should be made.

To avoid any doubt, the Lending Fund shall not be entitled to set off any amount owing to it in respect of a Contingent Loan and Interest against any amount owed by it to the **Fund**. The Lending Funds irrevocably waive any right they have to set off these amounts to the extent allowed for by law.

## Realistic Support

If there's a Realistic Deficit in the **Fund** after allowing for the Statutory Support described above, the following support mechanism shall apply

- A. Shareholders will conditionally waive their rights to transfers from the **Fund**. If in future the realistic balance sheet shows no realistic deficit or a reduced one, then the waiver will be rescinded.
- B. If waiving the charges in A isn't enough to eliminate the Realistic Deficits, part of the right of the DCP Fund to payments from the **Fund** to cover the cost of purchasing pension benefits will be conditionally waived. If in future the realistic balance sheet shows no realistic deficit or a reduced one, then the waiver will be rescinded.
- C. Any remaining Realistic Deficit after the application of sub-paragraphs A and B shall be addressed as follows:
  - 1) the part of the remaining Realistic Deficit relating to Intrinsic Cost shall be immediately extinguished by the transfer of property from the Lending Fund; and
  - 2) the part of the remaining Realistic Deficit relating to Future Volatility Cost shall be met by a charge on future surpluses (calculated before any transfer to the investment reserve) projected to arise in the Lending Fund.
- D. Any remaining Realistic Deficit following the application of sub-paragraphs A, B and C shall be extinguished by a transfer of property to the **Fund** from the SH Fund,  
and
- E. For the avoidance of doubt, if any future Realistic Balance Sheet demonstrates that not all elements of support specified in this paragraph continue to be required, the elements of support shall be withdrawn in the reverse order of application.

If a Realistic Deficit remains and ZAL doesn't have enough free assets to meet any Individual Capital Guidance applicable, a reduced Realistic Basis Contingent Loan may be made from the Lending Fund to the **Fund**. After each quarter, the **Fund** will pay interest on the Contingent Loan to the Lending Fund. If paying this interest means another Contingent Loan is needed then another loan will be made. The **Fund** will pay back the Contingent Loan when there is no longer a deficit. For this to happen though, the Board, with advice from the With-Profits Actuary, has to agree that the repayment is consistent with the obligations to take account of the interests of customers and provide them with a good outcome and a fair value.

If there's a Realistic Deficit in either of the Realistic Balance Sheets for the 100:0 Fund and the **Fund**, then the support will be provided in proportion to the Realistic Deficits in these funds.

Additional technical provisions will be maintained in the NP Fund and the DCP Fund to the value of the Eliminated Deficit Assets. The Eliminated Deficit Assets shall be re-calculated by the Board, with advice from the Actuarial Function. The recalculation will happen at least once every 12 months.

# Appendix C – Overseas-type business

## Overview

Overseas-type business includes

- Eagle Living policies written through the Hong Kong branch (with a small number written directly in the UK) and
- Cosmos policies written through the Isle of Man branch.

ZAL's closed to new overseas-type with-profits policies.

## Amounts Payable on Claims

Premiums are allocated to units and charges are deducted in line with policy conditions.

On surrender, death or maturity, the realisable value of the policy is payable in line with policy conditions.

This realisable value will include any dividends accrued up to the date of the claim, subject to any minimum value or guarantee that may be included in the policy conditions.

On funds that offer steady growth to support guaranteed maturity values or guaranteed investment returns, there may be restrictions on surrenders out of the fund and the realisable value on surrenders may incorporate a Market Value Reduction to protect the interests of continuing policyholders in the **Fund**.

## Dividend Policy (Bonus Policy)

Our policy on dividends on this business is strongly influenced by the investment strategy of the fund(s) supporting particular groups of policies.



Annual dividends declared, on funds that offer steady growth to support contract guarantees also take account of future dividends the funds are expected to be able to generate based on the assets they hold and the liabilities they support.

An interim dividend may be paid on claims on these funds - to allow for any distributable earnings not reflected in the latest annual dividend.

For funds that invest in bank deposits or mutual funds, the monthly dividends declared closely follow the performance of the assets of the fund. No final dividends are paid because the annual, interim or monthly dividends fully reflect the available earnings that can be distributed to policies.

## Smoothing

Limited smoothing may apply on funds that offer steady growth to support contract guarantees. For example, changes between

- the annual dividends declared out of past earnings to
- the annual dividends that are expected to be supportable in the future

may be smoothed in over a few years.

The impact of this smoothing is limited given that the annual dividends are intended to reflect closely the distributable earnings for the whole portfolio of policies invested in the fund.

On funds invested in bank deposits or mutual funds the monthly dividends closely reflect the distributable earnings and include little smoothing.

## Investment Strategy

Overseas-type contracts are supported by funds with investment strategies that are quite distinct from the investment strategies of the rest of the **Fund** relating to UK-type policies.

Funds that are intended to provide steady growth to support contract guarantees are invested in bonds with good credit ratings denominated in major currencies that are a good match to the liabilities. There are also funds that invest in bank deposits or mutual funds.

# Glossary

<b>Actuarial Function:</b> The function described in the Conditions Governing Business 6.1 of the PRA Rulebook, with responsibility for advising the ZAL Board on the actuarial management of the business.	<b>Actuary:</b> A Fellow or an Associate of the Institute and Faculty of Actuaries.
<b>Call Option:</b> A contract giving the right but not the obligation to buy an asset at a fixed price on a future date.	<b>Conduct of Business Sourcebook (COBS):</b> The part of the FCA Handbook of rules and guidance containing the detailed conduct of business requirements for firms regulated by the Financial Conduct Authority. Chapter 20 of COBS provides rules and guidance on the operation of with-profits business.
<b>Eliminated Deficit Assets:</b> Assets at least equal in value to the amount of a Realistic Deficit which is eliminated by the application of the Realistic Support described in Appendix B.	<b>FCA Handbook:</b> The rules and guidance of the Financial Conduct Authority.
<b>Future Volatility Cost:</b> The excess of the current value of a liability in a Realistic Balance Sheet over the Intrinsic Cost.	<b>Guaranteed benefits:</b> The guaranteed minimum level of benefits payable on a claim under a life insurance or pension policy, as defined in the policy conditions. Different levels of guaranteed benefits may apply in different circumstances.
<b>Independent Person:</b> A person with appropriate skills and expertise who is independent of ZAL who is asked by ZAL to report on how it has complied with the Principles and Practices of Financial Management.	<b>Individual Capital Guidance:</b> The Solvency Capital Requirement as given by the PRA in accordance with the PRA Rulebook.
<b>Intrinsic cost:</b> The excess of the current value of a liability in a Realistic Balance Sheet (at the date the Realistic Balance Sheet is prepared) over the current value (at such date) of the assets held to pay that liability.	<b>Liabilities:</b> The liabilities of the <b>Fund</b> include guaranteed liabilities; liabilities in excess of guaranteed liabilities arising from the expectation that future bonus payments will be made in accordance with the principles and practices set out in this document, including making allowance for smoothing; current liabilities, such as pending claim payments and other amounts accounted for but not yet received or paid out; and any other financial costs arising from the management of the <b>Fund</b> .
<b>miscellaneous profits or losses:</b> Profits or losses which arise in a with-profits fund, but which are not credited or charged to asset shares.	<b>Policy conditions:</b> For a given life insurance or pensions policy, the legal document which sets out the respective rights and obligations of ZAL and the customer.
<b>Put Option:</b> A contract giving the right but not the obligation to sell an asset at a fixed price on a future date.	<b>Realistic Balance Sheet:</b> A balance sheet produced to demonstrate whether, or not, a Realistic Deficit exists in the <b>Fund</b> .
<b>Realistic Deficit:</b> A Realistic Deficit exists at any time when, and in the amount by which, the Realistic Value of liabilities exceeds the Realistic Value of assets prior to the application of the relevant provisions of Appendix B.	<b>Regulator:</b> The Financial Conduct Authority, Prudential Regulation Authority or any other regulatory body as defined in accordance with the provisions of the Financial Services and Markets Act 2000 or any superseding legislation.
<b>Statutory Deficit:</b> The amount by which, in the opinion of the Board, with advice from the With-Profits Actuary, the Regulatory Value of the Assets of a fund is less than the Regulatory Value of all insurance and non-insurance liabilities of that fund.	<b>Surplus:</b> In respect of a with-profits fund, profits or losses identified following an actuarial valuation of the assets and liabilities of the fund calculated using actuarial methods consistent with the relevant regulations. Some of the accumulated surplus will be deemed to be distributable in the form of bonuses.
<b>With-Profits Actuary:</b> The function of With-Profits Actuary described in the Supervision Manual of the FCA Handbook, which principally involves advising the ZAL on its use of discretion in respect of with-profits business. The With-Profits Actuary is appointed by ZAL.	<b>with-profits business:</b> The business of ZAL which comprises with-profits policies.
<b>with-profits policies:</b> A policy which is entitled to share in the profits or losses of the with-profits fund in which it is held.	

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Registered Office: Unity Place, 1 Carfax Close, Swindon, SN1 1AP.

Telephone 0370 514 3624

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