

Scottish Friendly Assurance Society Ltd

**Principles and Practices of Financial Management
for With-Profits Business Transferred from
London Aberdeen & Northern Mutual Assurance Society**

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1. Introduction

- 1.1 The Conduct of Business sourcebook of the Financial Conduct Authority ('FCA') requires firms to establish and maintain 'Principles and Practices of Financial Management' ('PPFM') to govern their conduct of their with-profits business.
- 1.2 This document sets out the PPFM that Scottish Friendly Assurance Society Limited ("the Scottish Friendly", "we" or "us") apply in managing the with-profits business (the "LANMAS with-profits business") transferred from London Aberdeen & Northern Mutual Assurance Society Limited ('LANMAS') on 31 December 2007 and in ensuring that customers are treated fairly. The PPFM are not intended to alter the rights and obligations we have under the Scheme of Transfer from LANMAS or any policy documents that have been issued to policyholders. Should there be any conflict between the PPFM and what is said in the Scheme of Transfer or any such policy document then the Scheme of Transfer or policy document (as appropriate) will prevail.
- 1.3 Scottish Friendly was established as a friendly society in 1862 and is incorporated under the Friendly Societies Act 1992. We are a mutual society and so have no shareholders. Scottish Friendly has a Board of Directors, which is the ultimate governing body for Scottish Friendly, and distribution of surplus and bonuses is determined by the Board upon the advice of the With-Profits Actuary.
- 1.4 We have established procedures to ensure that the Directors can satisfy themselves at regular intervals that the with-profits business is being managed in accordance with the PPFM; these procedures include formal reports from the With-Profits Actuary and an Independent Person appointed to review PPFM compliance to the Board.
- 1.5 Within our Main Fund we maintain separate Industrial and Ordinary business funds but only operate one pool of assets for our (non-linked) business. This includes non-profit and both conventional and unitised with-profits business. We manage our overall financial position taking into account both funds in aggregate.
- 1.6 We also operate a number of separate, notional funds in respect of business which has transferred to us, such as LANMAS business, to ensure an orderly run-off of the business. The opening fund comprises the assets and liabilities of LANMAS, less any costs and contingencies associated with the transfer, as at the transfer date. This PPFM document covers the operation of the LANMAS With-Profits Business. Separate PPFM documents cover Scottish Friendly's other with-profits business funds in respect of business written by us (Conventional and Unitised) and other transferred funds (such as Rational Shelley and Scottish Legal Life).
- 1.7 The Principles are high-level statements that reflect the general approach adopted in managing the Main Fund and the notional funds and are not expected to change often. If the Board decides that a Principle should be changed, the procedures that will be followed are set out in Section 12.

- 1.8 The Practices are statements of specific practice employed in managing the with-profits business. They reflect the current approaches given the particular circumstances and economic conditions. Practices are likely to be revised in response to changes in the regulatory, business and economic environment and as new methods and techniques are developed in the life and pensions industry. However, the different Practices would still need to conform to the Principles. The procedures for changing Practices are set out in Section 12.

2. With-Profits Policies

- 2.1 Conventional with-profits policies have a guaranteed amount of cash benefit (Basic Sum Assured) to which bonuses are added. The guaranteed amount is payable on a specified event or date stated in the policy document provided all premiums under the policy are paid when due. Bonuses are additions to the benefits payable on with-profits policies and usually take one of two forms: regular (or reversionary) bonuses which are added throughout the policy term and final (or terminal) bonuses which (if payable) are only added at the date of a payout. Regular bonuses can be declared as a percentage of the guaranteed amount and/or a percentage of the previously declared regular bonuses and are added yearly; terminal bonus is expressed as a percentage of the sum assured and/or total regular bonuses added to the date of the claim and depends on the duration of the policy at the date of the claim. Final bonus is not explicitly paid on the surrender of a conventional with-profits policy but for these types of policy the surrender value makes some implicit allowance for final bonus.
- 2.2 LANMAS Unitised with-profits policies premiums are invested in the LANMAS Business Fund; units are allocated to policies as premiums are paid (and in some cases may be cancelled to meet expense charges and the cost of life cover or other benefits). Benefits are defined with reference to the value of units allocated to a policy. Bonuses are additions to the benefits payable on with-profits policies and usually take one of two forms: regular (or reversionary) bonuses which are added throughout the policy term and final (or terminal) bonuses which (if payable) are only added at the date of a payout. Regular bonuses are declared in the form of daily increases in the price of with-profits units and the policy contract provides details of when the unit price is guaranteed. At all other times a “Market Value Adjustment” may be deducted from the value of units to ensure that the benefit payment is fair (see section 6.2 below). Final bonuses may be payable once with-profits units have been continuously held for a prescribed period, expressed as an increase in unit value as at the claim date.
- 2.3 The with-profits business which was transferred from LANMAS consisted primarily of unitised with-profits policies and this document is therefore written primarily to provide information on the management of unitised with-profits business.
- 2.4 A number of older conventional with-profits policies were also transferred where, for the vast majority, policyholder contact has been lost and policyholders are considered untraceable. The treatment of any remaining conventional with-profits business will be similar to the treatment of unitised with-profit business except where otherwise explicitly stated.

3. Overriding Principles

3.1 Scottish Friendly has three overriding principles that can be regarded as overriding the principles and practices contained elsewhere herein if they come into conflict. These are:

- (a) We will manage our business in accordance with all legal and regulatory requirements.
- (b) We will manage our business in a sound and prudent manner with due regard to the interests of our policyholders and with a view to treating all policyholders fairly.
- (c) We will aim to manage our business in order to ensure that all guaranteed benefits can be paid as they fall due.

4. Methods of determining claim values

4.1 Principles

- 4.1.1 We will use appropriate models, methods and techniques to manage the with-profits fund and determine payouts.
- 4.1.2 For the main classes of with-profits business, payouts will be determined having regard to asset shares to endeavour that fairness is maintained between different groups and generations of policies. Asset shares represent the accumulated value of a policy using the actual experience of Scottish Friendly in terms of net investment return, mortality, expenses, and other charges.
- 4.1.3 For unitised with-profit business, the amount payable on claim is determined as the value of units at the quoted unit price, which increases over time due to the addition of regular bonuses, plus any final bonuses and less any Market Value Adjustments that apply on the date of the claim. We aim to distribute the surplus fairly and equitably between each policyholder, each class of policyholder and each generation of policyholder by using a combination of regular bonuses and final bonuses.
- 4.1.4 Our method of determining the total amount payable to a with-profits policyholder aims to ensure that on average over the longer term the amount paid out on maturity and surrender claims is 100% of the asset share, subject to the solvency position of Scottish Friendly. This average is taken over all policies becoming claims over a number of years, so that in any one year the amounts paid out on claims may be more or less than 100% of asset shares. This ‘smoothing policy’ is described in more detail in Section 6 below.
- 4.1.5 Any approximations which are used should not materially affect resulting payouts or bonuses compared to the result of more precise methods which could practicably have been used at a reasonable cost.
- 4.1.6 For classes of business where asset shares do not represent an equitable guide to payouts (including all conventional with-profits business), payouts will be determined by other appropriate methods.

4.2 Practices

- 4.2.1 For the main classes of with-profits business payouts will be determined having regard to asset shares (see below) to endeavour that fairness is maintained between different groups and generations of policies.
- 4.2.2 Asset shares are determined for all main policy classes as:

Asset share at the start of the period
Plus premiums received
Plus investment return (which can be negative) on the underlying assets
Minus cost of death or other risk benefits
Minus Charges for expenses, tax and guarantees

- 4.2.3 Asset shares for the major classes of unitised with-profits business are based on the use of a 'shadow fund'. The shadow fund is the value of units held by unitised with-profit policyholders based on the market value of underlying assets, rather than the quoted unit price. The investment returns allocated to shadow funds are the investment returns on the LANMAS Business Fund's non-linked funds in respect of the relevant asset mix.
- 4.2.4 Profits from non-profit business or other miscellaneous sources will be included in the calculation of asset shares as part of the management and distribution of the Estate (see Section 10).
- 4.2.5 Approximate methods may be used for minor lines of business and when insufficient data precludes the use of more precise methods.
- 4.2.6 For older conventional with-profits business, the small sum assured and premium size means that asset share calculations would not give meaningful results and payouts will be determined by other appropriate methods such as considering the return on premiums paid.
- 4.2.7 The methods, parameters and assumptions underlying these calculations are documented each year and signed off by the With-Profits Actuary. Any changes to current methods, parameters or assumptions relevant to a particular method have to be approved by the With-Profits Actuary and reported to the Board.

5. Bonus Policy

5.1 Principles

5.1.1 The distribution of surplus and bonuses is determined by the Board upon the advice of the With-Profits Actuary. In giving the advice the With-Profits Actuary will take into account:

- the need to ensure that Scottish Friendly is able to meet its statutory liabilities;
- the current and possible future capital needs of Scottish Friendly;
- the Scheme of Transfer of the LANMAS business;
- the investment strategy (see Section 7 below);
- the bonus policy (described in Sections 4, 5 and 6);
- regulatory requirements about protecting with-profits policyholders; and
- the need for an appropriate level of security for policyholders' benefits.

5.1.2 We aim to distribute the surplus fairly and equitably between each policyholder, each class of policyholder and each generation of policyholder by using a combination of regular bonuses and final bonuses. For unitised with-profit business the amount payable on claim is determined as the value of units at the quoted unit price, which increases over time due to the addition of regular bonuses, plus any final bonuses and less any Market Value Adjustments that may apply on the date of the claim.

5.1.3 Part of the surplus is allocated to the with-profits policyholder each year in terms of a reversionary or regular bonus added to the unit price (although this can be nil); the policy contract provides details of when the unit price is guaranteed. Regular bonuses will be added when appropriate to provide policyholders with additional guaranteed benefits; the aim in setting regular bonus rates is to increase policy values in line with the average redemption yield on medium to long term government bonds less a margin to cover the charges for expenses and guarantees at a level considered sustainable in the long term. Where necessary however the Board will restrict regular bonus rates in order to protect the solvency of Scottish Friendly or to ensure the maintenance of a reasonable balance between the guaranteed benefits and final bonuses payable at maturity to avoid the build up of excessively costly guarantees in the sub-fund.

5.1.4 We aim to avoid wide fluctuations in bonus rates. However, in situations where Scottish Friendly's solvency is under threat, or there is not expected to be sufficient surplus in the fund, we may act to reduce bonus rates significantly, and ultimately may decide not to pay a final bonus or reduce previously indicated levels of final bonuses.

5.1.5 The bonus policy will be regularly reviewed to ensure it remains appropriate. Any changes made to the bonus policy will be communicated to policyholders in a timely and appropriate manner, and the reasons for the changes will be explained.

5.1.6 The rate of final bonus will be set so that payouts on maturity will be close to the asset share of the policy, but not reflecting day to day fluctuations in asset share due to market volatility.

5.2 *Practices*

5.2.1 We do not currently declare any regular bonuses in respect of LANMAS business except for certain contracts where there is a guarantee that a minimum rate of regular bonuses will be declared. All other bonuses declared are in a final, non guaranteed, form.

5.2.2 Final (or terminal) bonuses are only payable at the time of a claim, and reflect more closely the performance of the fund at that time; they are not guaranteed and tend to fluctuate. We aim to target payouts at 100% of asset shares, subject to the smoothing policy described in Section 6 below. Before the LANMAS Business Fund is wound-up (see Section 10), the target is for at least 90% of surrender and maturity payments to fall within the range 80% to 120% of the unsmoothed asset share. Once the LANMAS Business Fund is wound-up the target is for at least 90% of surrender and maturity payments to fall within 90% to 110% of the unsmoothed asset share.

5.2.3 Final bonuses may fall to zero in some circumstances such as significant falls in the values of the fund's assets. Our current approach is to review final bonuses (and Market Value Adjustments) six-monthly although more frequent reviews will be undertaken in volatile market conditions.

5.2.4 The effect of any approximations used in setting bonus rates is intended to be neutral, both within each class or generation of policyholders and in aggregate. In the majority of cases, the most significant approximation for unitised with-profits policies is the grouping of policies by duration in setting the scale for, and in applying, any terminal bonus and/or Market Value Adjustment.

5.2.5 For the conventional with-profits business that remains, the method of distributing bonuses is as described in Section 2 above. Although asset share methods are not appropriate for this business the intention of paying out a fair and equitable share of surplus remains.

6. Smoothing Policy

6.1 Principles

- 6.1.1 Our smoothing policy aims to operate so that under and overpayments to the underlying asset share will be balanced out over time. The aim over the longer term is to share out all of the surplus earned on the fund subject to the financial resources available.
- 6.1.2 The extent of smoothing will be constrained so that the cost of smoothing to the fund is broadly neutral over the long term.

6.2 Practices

- 6.2.1 Market Value Adjustments may be applied to unitised with-profits claims other than on death to maintain fairness between policyholders exiting the fund, and those remaining in it. Some policies allow regular income payments to also be taken free from any Market Value Adjustment. Market Value Adjustments will only be applied due to the effects of movements in the value of assets held by the fund and the level of the reduction will be set so that payouts will be close to the asset share of the policy based on the underlying shadow fund.
- 6.2.2 Our current practice is not to smooth claim values, and in most situations a Market Value Adjustment will be applied where necessary to ensure that the shadow fund is paid out when this is less than the face value of units. The exceptions to this are in the event of death and where regular income withdrawals are made on a contractual basis. In these situations the face value of units will normally be used. In the situation where a partial claim is made any MVA will apply on a proportionate basis. Our current practice is to apply the same approach for all policy types on claims of all sizes and terms, irrespective of the date at which they joined the fund.
- 6.2.3 For conventional with-profits business we aim to smooth claim values by the application of bonus rates that do not lead to a significant departure in payments under similar policies to those in recent years, subject to adjustment to reflect the most recent experience and subject to the financial resources available.

7. Investment Strategy

7.1 Principles

- 7.1.1 The LANMAS business is being run as a separate, notional fund. The aim of the investment strategy of the fund is to provide an orderly run-off of the transferred LANMAS business while preserving the ability of the LANMAS Business Fund to meet its commitments to policyholders.
- 7.1.2 In determining the mix of assets between different asset classes, the investment strategy will take account the maturity of the business, the financial strength of the LANMAS Business Fund, its ability to meet its regulatory capital requirements, and the long term expected returns available in each asset category and their volatility.
- 7.1.3 In considering the range of assets in which to invest, the fund may use derivatives and other financial instruments, within limits determined by the Board, to help manage risk or to aid efficient portfolio management. The fund may also include assets that are not normally traded to support the operation of the business provided that the fund also holds sufficient liquid assets to meet its requirements.
- 7.1.4 In determining the investment strategy of the LANMAS Business Fund, no reliance is placed on other assets of Scottish Friendly outside that fund.
- 7.1.5 There are currently no constraints on the investment strategy between different classes or generations of policyholders although this may change in future if appropriate given the profile of any relevant guarantees which apply.
- 7.1.6 Parameters for counterparty exposure have been set by the Board on the advice of the With-Profits Actuary taking into account regulatory requirements regarding admissibility and are monitored by the Board; the fund does not currently invest in derivatives but were it to do so appropriate constraints on counterparty exposures would be established.

7.2 Practices

- 7.2.1 The investment strategy of the LANMAS Business Fund, and the mix of assets between different classes of asset are subject to formal review each year and more frequently in volatile market conditions. In doing so, the mix of assets will vary according to the financial strength of the fund.
- 7.2.2 A high percentage of the LANMAS Business Fund is invested in gilts and investment grade corporate bonds. We aim to match as closely as possible the fund's liabilities with fixed interest securities of an appropriate term. The objective is to minimise as far as possible the exposure of the fund to changes in interest rates in the fixed interest investment markets.
- 7.2.3 At the end of 2009 the strength of the LANMAS Business Fund had improved to the point where it was considered that some investment in equity or equity

type assets was appropriate. The intention behind such investment is to achieve a better long term rate of return than it is likely to be achieved by investing solely in fixed interest securities.

- 7.2.4 The current intention is that no more than 40% of the fund will be invested in equities. However, this could change if the financial strength of the fund varies. The equity backing ratio would be reduced if necessary to ensure the solvency position of the fund was not compromised by an unsuitable asset mix.
- 7.2.5 It is also necessary to bear in mind that the business is in a run-off situation and that the assets held need to be sufficiently liquid to allow claims to be paid as they fall due.
- 7.2.6 The investment in equities applies only to the assets backing with-profits policy asset shares. The assets backing other liabilities and the fund's free capital will generally be invested in fixed interest securities.
- 7.2.7 High level checks are completed on a regular basis to ensure that the assets held by the fund continue to remain suitable taking due account of the nature and term of the policy liabilities calculated on a realistic basis. In particular, detailed consideration is given to the impact that any potential adverse market conditions may have on the solvency of Scottish Friendly.
- 7.2.8 Cash flows are monitored at a high level and various cash flow projections (updated at least annually) are available to help ensure the fund maintains sufficient liquidity.
- 7.2.9 The LANMAS Business Fund does not currently invest in derivatives but were it to do so Board approval would be required for their use either as part of efficient portfolio management or to help manage risk by matching specific liabilities or to protect solvency.

8. Exposure to business risk

8.1 Principles

- 8.1.1 As members of a mutual society, with-profits policyholders ultimately bear the risks and rewards of all business undertaken by Scottish Friendly. However, wherever possible, any such risks not arising from the LANMAS business itself will not be borne by the transferred LANMAS policyholders.
- 8.1.2 Any significant additional business risks to be undertaken by Scottish Friendly require the approval of the Board, acting on the advice of the With-Profits Actuary, and would be based on expectations of achieving appropriate returns for the with-profits policyholders commensurate to the risks borne; such returns would be compared to commercially available alternative investments. Due account may also be taken of the strategic implications of any new development. The Audit Committee of the Board is responsible for the effective risk management of Scottish Friendly, including consideration of the business risks being borne.
- 8.1.3 The LANMAS Business Fund will bear the risks associated with guarantees provided on the transferred LANMAS policies. The estate of the LANMAS Business Fund will normally bear the costs of meeting these guarantees but if the level of the estate falls below the level required to operate the smoothing policy and provide working capital, the costs of meeting guarantees may lead to more than a gradual change in the regular and final bonus rates.
- 8.1.4 The LANMAS Business Fund is exposed to the risk arising from maintaining non-profit policies. Any profits or losses arising from these risks, including any costs of compensation, accrue in the first instance to the estate of the LANMAS Business Fund but if the level of the estate falls below the level required to operate the smoothing policy and provide working capital, any losses may be funded by reducing the regular and final bonus rates.

8.2 Practices

- 8.2.1 The LANMAS Business Fund does contain non-profit policies.
- 8.2.2 The LANMAS Business Fund does not have any subsidiaries.
- 8.2.3 Any profits or losses arising from business risks in the LANMAS Business Fund are currently borne by the estate of the LANMAS Business Fund and are taken into account in operating the smoothing policy (see Section 6). However, if the level of the estate falls below the level required to operate the smoothing policy and provide working capital, any losses may be deducted from asset shares, pooled across all with-profits policies.

9. Charges and Expenses

9.1 Principles

9.1.1 The charges applied to the LANMAS business are as agreed in the Scheme of Transfer.

9.2 Practices

9.2.1 The expenses to be charged to the LANMAS Business Fund by the Main Fund are as follows:

- an administration charge of £32 p.a. per Ordinary Branch (OB) Business policy for 2008, subject to National Average Earnings increases annually (with a base month March 2007);
- 0.2% per annum on the funds under management across all asset classes and all investment vehicles (calculated on the average funds each quarter);
- where there is activity on an Industrial Branch (IB) Business policy, there will be an administration charge of £10 p.a. for each IB premium paying policy and a one-off administration charge of £10 for each IB claim. A contingency reserve for unclaimed IB policies will be maintained until the fund is wound-up (see section 10); and
- exceptional costs arising from the business that will be contained in the LANMAS Business Fund, such as all those arising from any mis-selling issues arising out of any of that business, will be charged separately by the Main Fund to the LANMAS Business Fund. Where an exceptional cost is incurred directly for the LANMAS Business Fund as a result of a legal, tax or regulatory change, it will only be charged to the LANMAS Business Fund to the extent it exceeds £20,000 in which case the whole amount will be recoverable by the Main Fund and not just the excess over £20,000.

10. Management of the Estate

10.1 Principles

- 10.1.1 The estate of each of the notional fund in respect of transferred LANMAS policyholders will be managed in accordance with its own PPFM. However, in circumstances where solvency is threatened the Main Fund may be supported by the notional fund. Similarly, should the notional fund be unable to support the relevant transferred business the Main Fund would be required to support the benefits.
- 10.1.2 A key objective is to distribute the estate of the LANMAS Business Fund to the LANMAS with-profits policyholders in a manner that is fair having regard to different classes and generations of the business.
- 10.1.3 At the end of 2018, or if less than 1,500 OB policies remain in-force in the LANMAS Business Fund, the estate of the LANMAS Business Fund may be allocated to the remaining with-profit policies and the LANMAS Business Fund wound-up. Scottish Friendly is entitled to defer winding up the LANMAS Business Fund.) The terms for winding up the LANMAS Business Fund and allocating the estate are set out in the transfer agreement and summarised below.
- 10.1.4 In the meantime the primary uses of the estate include:
- a) Promoting, the ongoing corporate purposes of Scottish Friendly including current and future generations of members;
 - b) Supporting the smoothing of benefits paid to with-profits policyholders;
 - c) Providing statutory capital to meet reserving requirements in excess of the asset shares;
 - d) Providing working capital to cover any mismatch in timing between the receipt of charges applied to policies in the fund and the actual expenses incurred in the maintenance of those policies;
 - e) Providing capital support to cover the costs of meeting guarantees; and
 - f) Meeting any exceptional costs in managing the with-profits business arising as a result of legislation, taxation or other circumstances which in the opinion of the Board should not be charged to policyholder benefits.
- 10.1.5 No target range has been set for the estate of the LANMAS Business Fund – rather it will be distributed by means of an enhancement to asset shares until such time as the LANMAS Business Fund is wound up with the aim of achieving equitable treatment between policyholders who exit the fund before and after it is wound-up.
- 10.1.6 If required by the solvency of the fund, we will restrict the investment policy of the fund and/or the smoothing of benefits to existing policyholders.
- 10.1.7 LANMAS policyholders will not benefit from any distribution of Scottish Friendly's estate existing in funds other than the LANMAS Business Fund.

10.2 Practices

- 10.2.1 Currently, the estate is being used to manage the smoothing process as described in Section 6. Where appropriate, as mentioned in Section 4, miscellaneous profits may be added to asset shares to help ensure that the estate is distributed fairly to with-profit policyholders both before and after the LANMAS Business Fund is wound-up.
- 10.2.2 The strength of the fund is such that it is appropriate to start distributing the estate. This will be implemented in the first instance by an enhancement to the calculated shadow funds with the intention of removing Market Value Adjustments for all in-force policies. Once this has been achieved a review will take place of the free capital remaining to consider whether further distributions can be made. If that is the case then the most likely form of distribution will be in the form of an enhanced value at the date of a claim.
- 10.2.3 Since the transfer of the business the investment strategy of the estate had been the same as that of the rest of the LANMAS Business Fund. The improving financial strength of the LANMAS sub fund at the end of 2009 led to a review of the assets backing the asset shares. A paper was submitted to the Board in May 2010 recommending that equities which were no longer needed to support unit-linked liabilities should be used to give the with-profits policies an exposure to equities. The holdings amounted to about 20% of the with-profits asset shares. The estate provides the capital support required to maintain the solvency of the fund. It is therefore important that in adverse market conditions the value of the estate is sufficiently robust to continue to maintain the solvency of the fund. The investment strategy of the estate may therefore tend to be more restricted than the rest of the fund.
- 10.2.4 At the time the LANMAS Business Fund is wound up, Scottish Friendly will merge all the business remaining in the LANMAS Business Fund into the Scottish Friendly's Main Fund and thereafter all provisions of this PPFM shall cease to apply and Scottish Friendly shall instead implement the following arrangements:
- (a) the Board (having taken the advice of the With Profits Actuary) shall determine the realistic surplus of the LANMAS Business Fund for allocation in favour of LANMAS policyholders whose with-profits policies are then still in force; and
 - (b) the Board (having taken the advice of the With Profits Actuary) shall determine and if appropriate make enhancements to the asset shares of relevant with-profits policies (where asset shares can be calculated and fall to be calculated under this PPFM) or (in any other case such as classes of conventional business) shall determine and if appropriate make enhancements to the guaranteed benefits of the relevant with-profits policies such that the amount and method of allocating such is fair having regard to different classes and generations of such policies; and the aggregate value of such enhancements shall be equal to the realistic surplus of the LANMAS Business Fund;

- (c) the property and liabilities of the LANMAS Business Fund shall be allocated to Scottish Friendly's Main Fund; and
- (d) once allocated to Scottish Friendly's Main Fund the with-profits policies shall be managed in a manner consistent with the most similar other policies then allocated to Scottish Friendly's Main Fund but with such modifications as may be appropriate with a view to there being, in the opinion of the With Profits Actuary, no material adverse change in the reasonable expectations of with-profits policyholders following the allocation of such policies to Scottish Friendly's Main Fund.

11. Volume of new business

11.1 Principles

The fund is closed to new business.

11.2 Practices

The fund is closed to new business.

12. Amendment of the Principles and Practices

12.1 Principles

12.1.1 The Board may amend the Principles in this document but only upon the advice of the With-Profits Actuary; the Independent Person appointed to review PPFM compliance will be consulted before any changes are made to the Principles.

12.1.2 If the With-Profits Actuary believes that any proposed amendment to the Principles will or may have a material effect upon the rights or reasonable expectations of policyholders he shall give notice of such proposed amendment to the FCA.

12.1.3 Policyholders will be provided with three months' notice prior to the effective date of any change to the Principles.

12.2 Practices

12.2.1 The Board may amend the Practices in this document on the advice of the With-Profits Actuary, who will provide his written opinion on whether the proposed changes are consistent with the Principles.

12.2.2 Policyholders (and if appropriate the FCA) will be notified of changes to Practices. Details will be displayed on Scottish Friendly's website within 14 days of their implementation and policyholders will be advised of the nature of any changes in their next regular mailing from Scottish Friendly.

12.3 Minor Changes

12.3.1 Notwithstanding the above, the Board may amend the PPFM if that change:

- is necessary to correct an error or omission in the PPFM, or
- would improve the clarity or presentation of the PPFM without materially affecting its substance; or
- is immaterial.

12.3.2 Changes made in these circumstances will not necessarily be notified to policyholders as described in Sections 12.1 and 12.2 above.

12.4 Compliance and Record Keeping

12.4.1 The Independent Person appointed to review PPFM compliance will assist the Board in ensuring compliance with the PPFM and the maintenance of governance arrangements to achieve this.

12.4.2 Whenever the PPFM document is changed, Scottish Friendly will:

- Document the changes and keep previous versions of the PPFM for at least 6 years;
- Ensure that revised procedures and systems are properly documented; and
- Ensure the implementation of the change(s) is properly managed with appropriate change controls.

13. Glossary

Asset Share

The accumulation of premiums less charges for expenses, tax, guarantees and the cost of life assurance and cost of other risk benefits plus the investment return on the underlying assets.

Bonus reserve valuation

A method of determining the value of future liabilities under a life insurance contract. Future benefits, including guaranteed benefits, regular bonuses, final bonuses, where appropriate, plus future expenses and less future premiums are discounted at a rate of interest usually based on current market conditions.

Conventional with-profits policy

Policy that has a guaranteed minimum cash sum (the basic sum assured) to which bonuses are added.

Derivative

A financial instrument usually including an option to trade in securities at a fixed price at some future date.

Final Bonus

Bonus added when there is a claim

***Estate
(of the LANMAS Business Fund)***

The difference between the market value of assets and the asset share and provision for guarantees.

Industrial Branch Business

Business where home service agents originally collected the policy premiums in cash.

Main Fund

The main fund of Scottish Friendly comprising its Industrial Branch and Ordinary Branch with profits business, related non profit business and Estate (but excluding any notional funds in respect of Transferred Business).

Market Value Adjustment

A reduction in the unit value on any claim other than on maturities and deaths.

Notional Fund

A notional sub-fund of the with-profits fund covering Transferred Business.

<i>Regular bonus</i>	Bonus that is added yearly.
<i>Smoothing</i>	A means by which long term returns on with-profits policies are adjusted to even out the short term high and low investment returns.
<i>Surplus</i>	The excess of premiums and investment return over claims, expenses, taxation and the increase in liabilities calculated as required by the Regulations.
<i>Surrender value</i>	The claim value paid when a policy is voluntarily discontinued by the policyholder before the maturity date.
<i>Transferred Business</i>	Business that has been transferred from another Society or Insurance company where the terms of the transfer have provided for a separate notional fund to be established. The fund being earmarked to support the benefits of the transferred policies.
<i>Unitised with-profits policy</i>	Policy that has units allocated to which bonuses are added in the form of an increased unit price.
<i>With-Profits Actuary</i>	An actuary is a person with a professional qualification specialising in financial risk and particularly insurance risk. The term ‘With-Profits Actuary’ in the PPFM relates to the actuary with overall responsibility for advising the Board on how to apply the PPFM.