Scottish Friendly Assurance Society Ltd.

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

Effective: 01 November 2019

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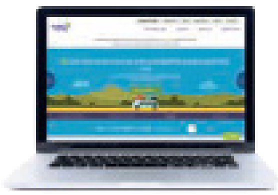

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We are proud to have been awarded the best UK Mutual Insurer at this year's Capital Finance International Awards.

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 The Board is required by FCA Rules to establish arrangements to ensure that there is appropriate independent oversight and challenge of the way it manages Scottish Friendly's With-Profits business. Scottish Friendly has established a With-Profits Committee to advise the Board. The Board continues to be advised by the With-Profits Actuary.

1.5 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 a formal report to the Board from the With-Profits Actuary reviewing PPFM compliance, subject to oversight from the With-Profits Committee.

1.6 Within our Main Fund we 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 in aggregate.

1.7 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, Scottish Legal Life and M&GM).

1.8 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.

1.9 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 polices 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: annual (or 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. Annual bonuses can be declared as a percentage of the guaranteed amount and/or a percentage of the previously declared annual bonuses and are added yearly; final bonus is expressed as a percentage of the sum assured and/or total annual 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: annual (or 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. Annual 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

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over time due to the addition of annual 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 annual 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, 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 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 annual bonuses and final bonuses. (The amount payable on death or maturity is determined by the sum assured, annual bonus and final bonus that apply on the date of claim.) Where appropriate in the circumstances, and on the advice of the With-Profits Actuary, surplus may also be 'distributed' in different ways – for example, to avoid excessive costs of collecting very small premiums for Industrial Business, surplus has in the past been used to make policies fully paid up; in addition, an advance of the surplus arising from the switch of payment method from home collection to direct debit was used to incentivise policyholders to switch.

5.1.3 Part of the surplus is allocated to a with-profits policy each year in terms of a annual bonus added to the sum assured. Provided the policy is maintained in force until maturity (or death) then, once declared, this annual bonus is guaranteed. Annual bonuses will be added when appropriate to provide policyholders with additional guaranteed benefits; the aim in setting annual 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 Directors will restrict annual 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 (or death).

5.1.4 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.

5.1.5 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. The limits on the maximum changes in payouts from one year to the next will be set in line with the Smoothing Policy described below (see 6.2).

5.2 Practices

5.2.1 We do not currently declare any annual bonuses in respect of LANMAS business except for certain contracts where there is a guarantee that a minimum rate of annual 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, where relevant.

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 final 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 5.2 above. Although asset share methods are not appropriate for this business the intention of paying out a fair and equitable share of surplus remains.7.1 Principles

7.1.1 The aim of the investment strategy of the Main Fund is to maximise the returns to with-profits investors while preserving the ability of the fund to meet its commitments to policyholders. In determining the mix of assets between different asset classes, the investment strategy will take account the financial strength of the fund, its ability to meet its regulatory capital requirements, and the long term expected returns available in each asset category and their volatility.

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 When policyholders choose to surrender their policies they receive a pay-out based on their asset share. Asset shares are updated each month and are held constant between updates. This means that pay-outs are not affected by market movements between the date of surrender and the date that asset shares were last updated. 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. Profits or losses that arise from this smoothing of pay-outs are borne by the estate of the LANMAS sub-fund.

7. Investment Strategy

7.1 Principles

7.1.2 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 takes account of 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 With-profits policyholders have a guarantee that the pay-out made on the death of a policyholder will be no less than the value of the policy's unit fund at the date of death. Scottish Friendly matches the expected cost of guaranteed benefits with fixed interest securities of an appropriate term.

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 The business in the LANMAS sub-fund is in run-off and the investment strategy reflects this. This includes consideration of the nature of the assets held, including how readily they can be realised to meet claims 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. 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 Risk 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. If the level of the estate falls outside of the target range referenced in section 10, Scottish Friendly may take various actions to bring the estate back to within its target range. These actions are described in section 10. In extreme circumstances these actions could include deducting from asset shares the cost of meeting guarantees in excess of charges already deducted.

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 annual and final bonus rates.

8.2 Practices

8.2.1 The LANMAS Business Fund contains non-profit policies.

8.2.2 The LANMAS Business Fund does not have any subsidiaries.

8.2.3 Any profits or losses arising from risks in the LANMAS Business Fund are borne by the estate of the LANMAS Business Fund. To the extent that the level of the estate falls outside the target range there are various management actions that could be taken with are discussed in section 10.

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 the LANMAS sub-fund will be managed in accordance with this 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) Supporting, 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) Supporting the sub-fund's investment strategy for the benefit of policyholders

d) Providing statutory capital to meet reserving requirements in excess of the asset shares;

e) 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;

f) Providing capital support to cover the costs of meeting guarantees; and

g) 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.

h) Supporting the investment strategy.

10.1.5 No target range has been set for the estate of the LANMAS Business Fund – rather it will 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

10.2.1The primary purpose of the estate is to provide capital to cover any losses that arise from the risks faced by the LANMAS sub-fund. These risks primarily arise from the non-profit business.

Each year, the Board, having taken the advice of the With-Profits Actuary, will consider the size of the estate in comparison to the minimum amount of capital that should be held in the LANMAS sub-fund in accordance with Scottish Friendly's Risk Appetite Framework. In the event that the estate exceeds the risk appetite then the Board may decide to use the excess to enhance asset share.

10.2.2 The Risk Appetite framework sets out the minimum level of capital that should be held in the Society and, separately, the minimum level of capital that should be held in the LANMAS sub- fund. The framework also sets out the trigger levels for the Society and for the fund, below which their capital positions would not be expected to fall. It also sets out upper limits. These limits and triggers are expressed as percentages of the regulatory capital requirement.

10.2.3 If the estate falls, or is reasonably expected to fall, below the minimum level, then Scottish Friendly will consider taking a range of actions depending on the current level of the estate and whether it is expected to increase or decrease over the foreseeable future. Scottish Friendly may initially consider taking actions such as reviewing regular bonus rates, suspending the application of the smoothing policy, and reduction of the equity backing ratio within normal ranges as set out in section 7.2.4. In the event that more extensive actions are required to restore the estate, Scottish Friendly may consider reducing equity backing ratios outside of the normal range, using derivatives to hedge risk, and removing part or all of any previous enhancements to asset shares reflecting any previous distributions of the estate. In extreme circumstances, Scottish Friendly may consider making further deductions from asset shares.

10.2.4 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.

10.2.5 At the time the LANMAS Business Fund is wound up, Scottish Friendly will merge all the business remaining in the LANMAS Business Fund into t 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

11.1.1 The fund is closed to new business.

11.2 Practices

11.2.1 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 With-Profits Committee 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

12.3.2 The With-Profits Committee 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

Annual bonus

Bonus that is added yearly.

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, annual 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.

Smoothing

A means by which long term returns on with-profits policies are adjusted to even out the short term high and low investment returns.

Surplus

The excess of premiums and investment return over claims, expenses, taxation and the increase in liabilities calculated as required by the Regulations.

Surrender value

The claim value paid when a policy is voluntarily discontinued by the policyholder before the maturity date.

Transferred Business

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.

Unitised with-profits policy

Policy that has units allocated to which bonuses are added in the form of an increased unit price.

With-Profits Actuary

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.