

### 5.(1)(C) Description of SAIF linked contracts continued

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Contracts which were written up to and including 26 July 2000 as increments to FlexiPension (Series 1) contracts have the same Guaranteed Annuity Option as the FlexiPension (Series 1) contract (see 4(C)(c)B on page 30).
- (k) These contracts ceased to be available in 1990, except for FlexiPension (Series 3) and IndePension (Series 1) which ceased to be available in 1988.
- (l) There were no increases in the rates of charges during the report period.

#### (v) *Series 2 pensions*

- (a) This category comprises MaxiPension (Series 2), OmniPension (Series 2), ExtraPension (Series 2), FlexiPension (Series 5 and Series 6) and IndePension (Series 3 and Series 4).
- (b) These are non-profit pure endowment contracts.
- (c) Single or regular (annual or monthly) premium.
- (d) MaxiPensions and OmniPensions are designed for exempt approved schemes and ExtraPensions for free standing AVCs. MaxiPension and OmniPensions have slightly different charges and are designed to appeal to different markets.

FlexiPensions and IndePensions are personal pension contracts for those in self-employment and employment respectively. FlexiPension (Series 5) and IndePension (Series 3) are for increments to FlexiPension (Series 1, 2 and 3) and to IndePension (Series 1 and 2) respectively, effected in terms of Chapter III of Part XIV of the Income and Corporation Taxes Act 1988.

A group personal pension version, Group IndePension (Series 2), is included with IndePension (Series 4).

Policies are written either to a normal retirement age (NRA) or a selected retirement age (SRA).

On retirement at the NRA or SRA the fund available is the value at the bid price of the units allocated.

On death before the NRA or SRA, the policyholder may receive:

- (i) the value at the bid price of the units allocated to the policy, or
- (ii) in the case of MaxiPension (Series 2), ExtraPension (Series 2), FlexiPension (Series 6) and IndePension (Series 4), the greater of a specified sum assured and the value at the bid price of the units allocated to the policy, or
- (iii) in the case of MaxiPension (Series 2), OmniPension (Series 2), ExtraPension (Series 2), FlexiPension (Series 6) and IndePension (Series 4), a specified sum assured in addition to the value at the bid price of the units allocated to the policy.

The personal pension contracts have a facility for waiver benefit, under which premiums are waived in respect of any period of incapacity, excluding the first six months and excluding periods of sickness when HIV positive or suffering from AIDS.

Accumulating with-profits versions of these contracts are also available as described in 4(C)(a)(1)D (page 29).

- (e) Not applicable.

## 5.(1)(C) Description of SAIF linked contracts continued

- (f) With effect from 6 April 2001 some charges were removed from IndePension (Series 4), FlexiPension (Series 6) and ExtraPension (Series 2) contracts. Following the changes, the allocation factor is 100% or, if greater, the original allocation factor less 5% bid/offer spread, premiums are allocated at bid price and no installation or annual member charges apply. Additional non unit reserves have been established where this results in future expenses exceeding charges.

### Regular premium policies:

Acquisition expenses and initial commission are recouped by an additional management charge of 1.8% per annum for a period of up to 25 years, of the units bought in the first three years of each benefit. This charge is met by the cancellation of units at the end of each policy year. Subject to the removal of charges with effect from 6 April 2001 referred to above, an installation charge is also applied at the set up of a policy.

Subject to the removal of charges with effect from 6 April 2001 referred to above, renewal expenses and renewal commission are met from the combination of the bid/offer spread and the allocation factor, from the annual management charge and from an annual member charge which is applied to one of each member's policies.

After 10 years the premium deemed to be allocated after allowing for the bid/offer spread and the allocation factor may exceed the amount of the premiums received. Any such enhancement is met from the annual management charge.

The cost of any sum at risk (i.e. the excess of the death benefit over the bid value of the units) is met by the monthly cancellation at the bid price of sufficient units to meet the cost for that month.

The cost of providing waiver of premium benefit is met by the monthly deallocation of units.

### Single premium policies (including DSS rebate only contracts):

Subject to the removal of charges with effect from 6 April 2001 referred to above, acquisition expenses and initial commission are recouped from the combination of the bid/offer spread and the allocation factor.

Subject to the removal of charges with effect from 6 April 2001 referred to above, renewal expenses are met from the annual management charge and from an annual member charge which is applied to one of each member's policies.

There may be instances, for longer term policies, where the amount of premiums deemed to be invested, after allowing for the effect of the allocation factor and bid/offer spread, is greater than the amount of the premiums. Any such enhancement is recouped from the annual management charge.

The annual management charge is currently 0.875% per annum, with the exception of the Exempt Global Balanced (US View) fund for which the annual management charge is 1.125% per annum.

- (g) Increases in member charges are normally restricted to increases in line with inflation unless it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The mortality rates used to calculate the cost of the death benefit may be changed if there is a significant change in the expected mortality experience of the Company's policyholders.

The rates used to calculate the charges for waiver of premium benefit can be changed if there is a significant change in the expectation that the Company's policyholders will suffer an accident or illness that leads to a claim.

## 5.(1)(C) Description of SAIF linked contracts continued

### (h) Regular premium policies:

The value of the policy on early retirement or surrender before the NRA or SRA is the bid value of the units less an early retirement charge and a discontinuance charge.

The early retirement charge is equivalent to the value of units that would have been cancelled by the future additional management charges assuming early retirement had not taken place.

A discontinuance charge may also be applied if the contributions under a regular premium policy are reduced or stopped prior to the attainment of NRA or SRA.

### Single premium policies:

The benefit on retirement or surrender before the NRA or SRA is the bid value of units less an early surrender charge which is calculated by reference to the outstanding proportion of the policy term.

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Contracts which were written up to and including 26 July 2000 as increments to FlexiPension (Series 1) contracts have the same Guaranteed Annuity Option as the FlexiPension (Series 1) contract (see 4(C)(c)B on page 30).
- (k) These contracts were closed to new business in 1994, except for FlexiPension (Series 5), IndePension (Series 3), MaxiPension (Series 2) and OmniPension (Series 2), which were available in SALAS until the transfer date. FlexiPension (Series 5) and IndePension (Series 3) are available for incremental business in SAIF. MaxiPension (Series 2) and OmniPension (Series 2) are available in SAL for non-contractual incremental business and new entrants to existing schemes, and in SAIF for contractual increments.
- (l) There were no increases in the rates of charges during the report period.

### (vi) *Series 3 pensions*

- (a) This category comprises MaxiPension Plus, OmniPension Plus, ExtraPension (Series 3), FlexiPension (Series 7) and IndePension (Series 5).
- (b) These are non-profit pure endowments.
- (c) Single or regular (annual or monthly) premium.
- (d) MaxiPension Plus and OmniPension Plus are for contracted-in exempt approved schemes only. ExtraPension (Series 3) is used for free standing AVCs. FlexiPension (Series 7) and IndePension (Series 5) are personal pensions contracts for those in self-employment and employment respectively. A group personal pension version, Group IndePension (Series 3), is included with IndePension (Series 5).

Policies are written either to a normal retirement age (NRA) or a selected retirement age (SRA).

On retirement at the NRA or SRA the fund available is the value at the bid price of the units allocated.

On death before the NRA or SRA, the policyholder may receive:

- (i) the value at the bid price of the units allocated to the policy, or
- (ii) in the case of MaxiPension Plus, ExtraPension (Series 3), FlexiPension (Series 7) and IndePension (Series 5), the greater of a specified sum assured and the value at the bid price of the units allocated to the policy, or

- (iii) in the case of MaxiPension Plus, OmniPension Plus, ExtraPension (Series 3), FlexiPension (Series 7) and IndePension (Series 5), a specified sum assured in addition to the value at the bid price of the units allocated to the policy.

The personal pension contracts have a facility for waiver benefit, under which premiums are waived in respect of any period of incapacity, excluding the first six months and excluding periods of sickness when HIV positive or suffering from AIDS.

Accumulating with-profits versions of these contracts are also available as described in 4(C)(a)(1)E (page 30).

- (e) Not applicable.
- (f) With effect from 6 April 2001 some charges were removed from IndePension (Series 5), FlexiPension (Series 7) and ExtraPension (Series 3) contracts. Following the changes, the allocation factor is 100% or, if greater, the original allocation factor less 5% bid/offer spread, premiums are allocated at bid price and no installation or annual member charges apply. Additional non-unit reserves have been established where this results in future expenses exceeding charges.

Subject to the removal of charges with effect from 6 April 2001 referred to above, acquisition expenses and initial/level commission are recouped by a combination of the bid/offer spread and allocation factor, and an installation charge which is deducted at the set up of each policy.

For single premium policies where full or part fund-related commission is selected, a service charge, met by quarterly deallocation of units, is applied to recoup the fund-related commission payable.

Subject to the removal of charges with effect from 6 April 2001 referred to above, renewal expenses and commission (where applicable) are met by the combination of the bid/offer spread and the allocation factor, an annual charge which applies to one of each member's policies and an annual management charge. (For regular premium-paying policies in up to the final 10 years of the policy, this is net of a rebate of 0.75% pa which applies to units in investment linked funds).

If the amount of premiums deemed to be invested after allowing for the effect of the allocation factor and bid/offer spread is greater than the amount of the premiums, any such enhancement is recouped from the annual management charge.

The cost of the sum at risk (i.e. the difference between the death benefit and the bid value of units) is met by the monthly cancellation at the bid price of sufficient units to meet the cost for that month.

The cost of waiver benefit is met by the monthly cancellation of units.

The annual management charge is currently 0.875% per annum, with the exception of the Exempt Global Balanced (US View) fund for which the annual management charge is 1.125% per annum.

- (g) Increases in member charges are normally restricted to increases in line with inflation except where it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The mortality rates used to calculate the cost of the death benefit may be changed if there is a significant change in the expected mortality experience of the Company's policyholders.

The rates used to calculate the charges for waiver of premium benefits can be changed if there is a significant change in the expectation that the Company's policyholders will suffer an accident or illness that leads to a claim.

## 5.(1)(C) Description of SAIF linked contracts continued

### (h) Regular premium policies:

The benefit on retirement or transfer before the NRA or SRA is the bid value of units less a discontinuance charge. This charge varies according to the term of the policy, premiums paid and the level and type of commission paid.

### Single premium policies:

The benefit on retirement or transfer before the NRA or SRA is the bid value of units less an early retirement charge. This charge is based on the difference in allocation factors for the original term and reduced term.

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were open to new business in SALAS before the transfer date and continued to be issued by SAL thereafter.
- (l) There were no increases in the rates of charges during the report period.

### (vii) Section 32 Buy-Out Plan

- (a) Section 32 Buy-Out Plan.
- (b) These are non-profit pure endowments.
- (c) Single premium.
- (d) The contract is designed to accept a transfer value from an occupational pension scheme. An accumulating with-profits version of this contract is also available as described in 4(C)(a)(1)F (page 30).

The contract is written with a normal retirement age (NRA) equal to that of the scheme from which the transfer is received.

Where GMP is to be provided, part of the transfer value must be invested in the Exempt With-Profits Fund and cannot subsequently be switched to any of the various internal linked funds. There is a guarantee that the accrued fund will be sufficient to meet all GMP liabilities at and after State Pension Age or on the investor's earlier death. A test of the adequacy of the transfer value to meet this guarantee is performed at the outset of the policy.

On death before benefits are taken, the sum available is the value at the bid price of the units allocated to the policy subject to a minimum of the GMP death benefit.

- (e) Not applicable.
- (f) Acquisition expenses and commission are recouped by a combination of the bid/offer spread and allocation factor, and an installation charge which is deducted at the set up of a policy.

Renewal expenses are met from the annual management charge. Prior to 6 April 2001 a member charge may also have been deducted annually. Member charges were discontinued with effect from 6 April 2001. Additional non-unit reserves have been established where this results in future expenses exceeding charges.

Where full or part fund-related commission is selected, a service charge, met by a quarterly deallocation of units, is applied to recoup the fund-related commission payable. In these cases, a higher allocation factor applies.

### 5.1(C) Description of SAIF linked contracts continued

For longer term policies, the amount of premiums deemed to be invested after allowing for the effect of the allocation factor and bid/offer spread may be greater than the amount of the premiums. Any such enhancement is recouped from the annual management charge.

The annual management charge is currently 0.875% per annum, with the exception of the Exempt Global Balanced (US View) fund, for which the annual management charge is 1.125% per annum.

- (g) Increases in member charges are normally restricted to increases in line with inflation unless it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.
- (h) The value of the policy on early retirement or surrender before the NRA is the bid value of units less an early retirement charge. This charge is based on the difference in allocation factors for the original term and reduced term to retirement.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) This contract was open to new business in SALAS before the transfer date, and continued to be issued by SAL until November 1998.
- (l) There were no increases in the rates of charges during the report period.

#### *(viii) Phased Retirement Plan Income Drawdown Plan*

- (a) Phased Retirement and Income Drawdown Plans.
- (b) These are non-profit pure endowments.
- (c) Single premium.
- (d) These contracts are designed to accept a transfer value from an existing tax-exempt pension arrangement.

For Phased Retirement, a partial encashment of the plan is allowed at any time, with part of the proceeds available as tax free cash and the remainder used to purchase an annuity.

For Income Drawdown, tax free cash may be taken at outset. Regular income is then withdrawn from the remaining fund, subject to minimum and maximum limits specified by the Inland Revenue.

Contracts are normally written to age 75 when the residual value must be used to buy a pension annuity.

The value of the fund on death prior to age 75 is the bid value of the units. This is used to provide benefits in accordance with the relevant Inland Revenue regulations.

Accumulating with-profits versions of these contracts are also available as described in 4(C)(a)(1)G (page 30).

- (e) Not applicable.

### 5.(1)(C) Description of SAIF linked contracts continued

- (f) Acquisition expenses and commission are recouped by the allocation factor and also from an establishment charge. This latter charge is equal to 0.13% per month of the amount invested and applies for the first five years of the contract, or to age 75 if earlier.

If the amount of premium deemed to be invested is greater than the amount of the premium, acquisition expenses and commission are still recouped from the establishment charge. This will occur only if the amount of initial commission selected is less than the 'basic' commission structure.

Fund-related commission is met by the annual management charge. A rebate of units is applied if the amount of commission is less than the 'basic' commission structure. Similarly a service charge, met by quarterly deallocation of units, is applied if higher commission is selected.

The annual management charge is currently 0.875% per annum, with the exception of the Exempt Global Balanced (US View) fund for which the annual management charge is 1.125% per annum.

- (g) There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.
- (h) For full surrenders, a surrender charge is applied equivalent to the total of the outstanding establishment charges described in paragraph (f) above.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were open to new business in SALAS before the transfer date and continued to be issued by SAL thereafter.
- (l) There were no increases in the rates of charges during the report period.

## 5. (1)(D) United Kingdom direct written linked contracts in SAA

### (i) *Capital Investment Bond*

- (a) Capital Investment Bond.
- (b) These are non-profit whole life assurance contracts.
- (c) Single premium.
- (d) The death benefit is normally 101% of the bid value of units. However, for Capital Investment Bond contracts effected prior to May 1986, the death benefit is calculated as a percentage of the bid value of units according to age at death. This percentage varies from 250% at age 30 to 101% at ages 75 and above.
- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by a combination of the allocation factor and the bid/offer spread.

In addition, for initial investments of less than £5,000, a shortfall charge is deducted based on the size of the investment.

Renewal expenses and commission are met from the annual management charge.

The annual management charge is currently 0.75% per annum, with the exception of the Global Balanced (US View) Fund for which the annual management charge is 1.00% per annum.

- (g) There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.
- (h) The surrender value at any time is the value at the bid price of the units allocated to the policy.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were closed to new business in 1997, although increments to existing Capital Investment Bond policies can still be accepted.
- (l) There were no increases in the rates of charges during the report period.

### (ii) *Capital Investment Bond (Series 2)*

- (a) Capital Investment Bond (Series 2).
- (b) These are non-profit whole life assurance contracts.
- (c) Single premium.
- (d) For Capital Investment Bond (Series 2) policies issued after 15 January 1996, the death benefit is 101% of the surrender value. For policies issued prior to this date, the death benefit is 101% of the bid value of the units.
- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by an establishment charge of 1.25% per annum of the fund for the first four years of the policy. For Capital Investment Bond (Series 2) policies issued before 15 January 1996, the establishment charge is 0.75% per annum of the fund for 5 years. The charge is met by deallocation of units on a monthly basis.

#### 5.(1)(D) Description of SAA linked contracts continued

In addition, for initial investments of less than £5,000, a shortfall charge is deducted based on the size of the investment.

The contract is sold on various commission terms: full initial commission, full fund-related commission or part initial and part fund-related commission. Where full or part fund-related commission is selected, higher allocation rates apply and the fund-related commission is met by a service charge taken by deallocation of units on a quarterly basis.

Renewal expenses are met by the annual management charge.

Where the investment exceeds £50,000 and/or where initial commission has been rebated, the premium deemed to be invested after taking account of the allocation factor may be greater than the amount of the premium. Any such enhancement is met from the establishment charges.

The annual management charge is currently 0.75% per annum, with the exception of the Global Balanced (US View) Fund for which the annual management charge is 1.00% per annum.

- (g) The annual management charge can only be increased if costs have increased by more than inflation and only to an extent consistent with the need to meet policyholders' reasonable expectations.
- (h) The surrender value at any time is the value at the bid price of the units allocated to the policy less an early discontinuance charge.

The maximum discontinuance charge is calculated as the bid value of units being withdrawn multiplied by the factor shown below.

Policy year	Factor
	%
1	7.5
2	6.0
3	4.5
4	3.0
5	1.5
6 and over	0.0

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were closed to new business on the transfer date.
- (l) There were no increases in the rates of charges during the report period.

#### **(iii) Scottish Amicable Distribution Bond**

- (a) Scottish Amicable Distribution Bond.
- (b) These are non-profit whole life assurances.
- (c) Single premium.
- (d) The Scottish Amicable Distribution Bond aims to provide an income which rises over the medium to long term. Distributions are made every quarter, on 1 March, 1 June, 1 September and 1 December. There is an option to have distributions paid monthly. Policyholders can elect to receive distributions, or reinvest them in the bond.

For policies issued before 15 January 1996, the death benefit is 101% of the bid value of units. For policies issued after this date the death benefit is 101% of the surrender value.

#### 5.(1)(D) Description of SAA linked contracts continued

A higher income option is available. Under this option, the policyholder can take a higher rate of distribution from the Distribution Bond by reducing the death and surrender benefits to a minimal amount. This option may be effected at any time, and once selected, the option remains in force for a period of five years, after which it may be reselected. If it is not, then the Bond reverts to being a normal Scottish Amicable Distribution Bond.

- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by an establishment charge of 1.25% per annum of the fund for the first four years of the policy. For policies issued before 15 January 1996, the establishment charge is 0.75% per annum of the fund for 5 years. This charge is met by deallocation of units on a monthly basis.

The contract is sold on various commission terms: full initial commission, full fund-related commission or part initial and part fund-related commission. Where full or part fund-related commission is selected, higher allocation rates apply and the fund-related commission is met by a service charge taken by deallocation of units on a quarterly basis.

Renewal expenses are met by the annual management charge.

Where the investment exceeds £50,000 and/or where initial commission has been rebated, the premium deemed to be invested after taking account of the allocation factor may be greater than the amount of the premium. Any such enhancement is met from the establishment charges.

The annual management charge is currently 0.75% per annum.

- (g) There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.
- (h) The surrender value at any time is the value at the bid price of the units allocated to the policy less an early discontinuance charge.

The maximum discontinuance charge is calculated as the bid value of units being withdrawn multiplied by the factor shown below.

Policy year	Factor
	%
1	7.5
2	6.0
3	4.5
4	3.0
5	1.5
6 and over	0.0

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) This contract was closed to new business on the transfer date.
- (l) There were no increases in the rates of charges during the report period.

## 5.(1)(D) Description of SAA linked contracts continued

### (iv) *Guaranteed Investment Bond*

- (a) Guaranteed Investment Bond.
- (b) These are non-profit whole life assurances.
- (c) Single premium.
- (d) There have been two issues of this contract with guarantee dates of 31 October 2001 and 30 August 2002.

The bond has a minimum value of 110% of the initial investment on the guarantee date, but there is no predetermined maturity date.

The benefit on death before the guarantee date is 101% of the surrender value, subject to a minimum death benefit of the initial investment. On or after the guarantee date, the death benefit is 101% of the bid value of units.

- (e) The bid value of units at the guarantee date (and the benefit on death prior to the guarantee date) is guaranteed not to be less than the original investment.
- (f) Acquisition expenses and initial commission are recouped from a combination of the allocation factor and the bid/offer spread. Renewal expenses are met from the annual management charge.

The annual management charge is currently 1.5% per annum.

- (g) There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.
- (h) The surrender value at any time before the guarantee date is 95% of the bid value of the units. On the guarantee date, the surrender value will be the greater of the bid value of units or 110% of the initial investment. After the guarantee date the surrender value is the bid value of the units.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) This contract was closed to new business in 1997.
- (l) There were no increases in the rates of charges during the report period.

### (v) *FlexiCover (Series 2)*

- (a) FlexiCover (Series 2).
- (b) These are non-profit whole life assurance contracts.
- (c) Regular (annual or monthly) premium.
- (d) For a given level of premium the policyholder may select any level of life cover between the minimum cover and the maximum cover.

The benefit on death is the greater of the life cover selected and the value of the units allocated at the bid price on the date of death. The contract is available on a single life, joint life or joint life last survivor basis.

The initial level of life cover selected is guaranteed only for the first 10 years. It is guaranteed that the level of life cover after 10 years (i.e. after the first review) will not be less than the minimum cover unless the contract is altered by the policyholder.

#### 5.(1)(D) Description of SAA linked contracts continued

At the end of 10 years and at regular intervals thereafter, the Company reviews the contract to determine whether the existing cover can be maintained at the current level and whether the premium needs to be increased.

The options under FlexiCover (Series 2) contracts are:-

- (i) Variation of cover option - At any monthly anniversary of the commencement date after two years there is an option for the selected cover to be reduced to not less than the minimum cover or, subject to underwriting, to be increased up to the maximum cover.
  - (ii) Change of life assured option - At any time after the second policy anniversary but not within two years of a previous exercise of this option, there are certain restricted options to alter the life assured on a single life basis or to alter from a single life basis to a joint life or joint life last survivor basis, or to alter from a joint life basis to a single life or joint life last survivor basis.
- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by a combination of the allocation factor and the bid/offer spread.

Renewal expenses and commission are met by a combination of the allocation factor and the bid/offer spread, a policy charge and the annual management charge.

The cost of the sum at risk (i.e. the excess of the life cover over the value of the units allocated at the bid price) is met by monthly cancellation of sufficient units to meet the cost for that month.

The annual management charge is currently 0.75% per annum.

- (g) Increases in policy charges are normally restricted to increases in line with inflation except where it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The mortality rates used to calculate the cost of the death benefit may be changed if there is a significant change in the expected mortality experience of the Company's policyholders.

- (h) The value on surrender is the value at the bid price of the units allocated to the policy, except that the Company reserves the right to make a discontinuance charge if fewer than three years' premiums have been paid.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) The contract ceased to be available in 1994 but existing policyholders had the option to effect a new policy in SALAS until the transfer date and in SAL thereafter.
- (l) There were no increases in the rates of charges during the report period.

#### (vi) Home Purchaser (Series 2)

- (a) Home Purchaser (Series 2).
- (b) These are non-profit endowment assurance contracts.
- (c) Regular (annual or monthly) premium.

#### 5.(1)(D) Description of SAA linked contracts continued

- (d) Home Purchaser (Series 2) is a low cost mortgage endowment plan.

An accumulating with-profits version of this contract is also available as described in 4(D)(a)(1)A (page 32). There is no option to switch investment between the investment linked and with-profits versions.

The benefit on maturity is the value of units allocated at the bid price.

The benefit on death is the greater of a minimum death benefit and the value of units allocated at the bid price on the date of death.

The contract has a facility for waiver of premium benefit, under which premiums are waived in respect of any period of incapacity, excluding the first six months and excluding periods of sickness when HIV positive or suffering from AIDS.

The contract also has the facility to incorporate at additional cost a critical illness benefit.

- (e) Not applicable.

- (f) Acquisition expenses and initial commission are recouped by a recurrent management charge of 2.75% per annum for a period of up to 25 years, of the value of units purchased by regular premiums in the first three years of the contract (or the first three years of any increments in regular premiums) ignoring any deallocation to meet other charges.

Renewal expenses and renewal commission are met by a combination of the allocation factor and the bid/offer spread, a policy charge and the annual management charge.

The cost of the sum at risk under the death and/or critical illness benefits (i.e. the excess of the relevant benefit over the value of the units allocated at the bid price) is met by monthly cancellation of sufficient units to meet the cost for that month.

The cost of the waiver of premium benefit is met by a monthly charge.

The annual management charge is currently 0.25% per annum.

- (g) Increases in policy charges are normally restricted to increases in line with inflation except where it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The mortality rates used to calculate the cost of the death benefit may be changed if there is a significant change in the expected mortality experience of the Company's policyholders.

The rates used to calculate the charge for waiver of premium benefits and critical illness benefits may be changed if there is a significant change in the expectation that the Company's policyholders will suffer an accident or illness which leads to a claim.

- (h) The surrender value is equal to the bid value of units less a surrender charge and, if the surrender is prior to three years' premiums having been paid, an early discontinuance charge. The surrender charge is equivalent to the value of units that would have been cancelled by the future recurrent management charges assuming the policy had run its full course and not been surrendered.

The early discontinuance charge is 24% of the annual premium (35% if premiums are paid monthly) after one premium has been paid decreasing linearly to zero after three yearly or 36 monthly premiums have been paid, the percentage being calculated on the contractual premiums payable during the fourth year.

The early discontinuance charge may also be applied if premiums are stopped before maturity.

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.

**5.(1)(D) Description of SAA linked contracts continued**

- (j) Not applicable.
- (k) This contract ceased to be available in 1995, although increments to existing policies can still be made.
- (l) There were no increases in the rates of charges during the report period.

**(vii) Home Purchaser (Series 3)  
Amicable Savings Plan**

- (a) Home Purchaser (Series 3) and Amicable Savings Plan.
- (b) These are non-profit endowment assurance contracts.
- (c) Regular (annual or monthly) premium.
- (d) Home Purchaser (Series 3) is a unitised low cost mortgage endowment plan. Amicable Savings Plan is a qualifying unitised endowment policy.

Accumulating with-profits versions of these contracts are also available, as described in 4(B)(a)(1)A (page 21). There is no option to switch investment between the investment linked and with-profits versions.

The benefit on death is the greater of a minimum death benefit and the value of the units allocated at the bid price on the date of death.

Reduced levels of charges apply to premium paying policies during their rebate period. The length of a policy's rebate period varies with the term of the contract as follows:

Term of contract	Rebate period
10 years	Final 6 years
15 years	Final 10 years
20 years	Final 13 years
25 years	Final 16 years

During the rebate period, the allocation factor is increased by 5.5% irrespective of commission shape, the policy charge is reduced by 50%, and there is a rebate of part of the annual management charge. The latter rebate is achieved by the monthly creation of additional units at a rate of 0.625% per annum of the fund.

The contract may include waiver of premium benefit, under which premiums are waived during any period of incapacity, excluding a deferred period of 3, 6 or 12 months and excluding periods of sickness when HIV positive or suffering from AIDS.

The contract also has the facility to incorporate at additional cost a critical illness benefit. The level of cover can be chosen to be either the same as for the death benefit, or a higher amount which decreases over the term of the policy to the level of the death benefit.

For Home Purchaser contracts there is a limited facility to increase the life cover or extend the term of the plan without evidence of health under the terms of a mortgage alteration option.

Amicable Savings Plans have an extension option which allows the term of the plan to be extended by a period of at least ten years from the original maturity date, and a mortgage conversion option under which the death benefit or critical illness cover or both may be increased and the term may be extended within the qualifying limits subject to underwriting.

## 5.(1)(D) Description of SAA linked contracts continued

For new Home Purchaser (Series 3) policies effected from July 1996 the following benefits were offered:

- (i) Mortgage Interest Benefit - this provides a monthly payment if the policyholder is unable to work through accident or sickness (excluding a deferred period of 3, 6 or 12 months). The amount of the payments are such that they will approximately cover the mortgage interest payments on a specified loan amount. Payments are restricted to a percentage of earnings prior to the claim.

No payments are made if the mortgage is no longer in existence. This benefit is available on a joint life or single life basis. For joint life cases, the benefit is not payable to both lives at the same time.

- (ii) Children's Critical Illness Cover - if a plan has critical illness cover then children's critical illness cover is included automatically at no extra cost. This provides a sum of 50% of the initial level of the main critical illness cover, subject to a maximum of £15,000, on one of the policyholder's children surviving for 14 days after the diagnosis of a critical illness.

For policies effected from 28 July 1997 the deferred period under the waiver of premium benefit and, if available, Mortgage Interest Benefit may be 3, 6 or 12 months. If both benefits are selected, the same deferred period will apply. Before 28 July 1997 the deferred period was set at 6 months.

- (e) Not applicable.
- (f) Acquisition expenses are recouped by a combination of the allocation factor and the bid/offer spread.

The contract is sold on various commission terms: full initial/renewal commission, full level commission throughout the policy term or part initial/renewal and part level commission. The allocation factors used through the term of a policy are adjusted to reflect the commission basis.

Renewal expenses are met by the policy charge and the annual management charge.

The cost of the sum at risk for the death and critical illness benefit (i.e. the excess of the relevant benefit over the value of the units allocated at the bid price) is met by monthly cancellation of sufficient units to meet the cost for that month.

The cost of the waiver of premium benefit is met by a monthly charge.

The cost of the Mortgage Interest Benefit is met by the monthly cancellation of sufficient units to meet the cost for that month.

During the rebate period there may be some policies where the premium deemed to be invested, after allowing for the effect of the allocation factor and bid/offer spread, is greater than the amount of the premium. Any such enhancement is met from the annual management charge.

The annual management charge is currently 0.75% per annum.

- (g) Increases in policy charges are normally restricted to increases in line with inflation except where it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The mortality rates used to calculate the cost of the death benefit may be changed if there is a significant change in the expected mortality experience of the Company's policyholders.

The rates used to calculate the charge for waiver of premium benefit and critical illness benefits may be changed if there is a significant change in the expectation that the Company's policyholders will suffer an accident or illness which leads to a claim.

#### 5.(1)(D) Description of SAA linked contracts continued

The rates used to calculate the charge for the Mortgage Interest Benefit may be changed to take account of changes in the level of the Halifax Building Society's lending rate. Also, they can be changed if there is a significant change in the expected frequency or duration of claims arising.

- (h) On surrender, the value of units at the bid price is reduced by an early discontinuance charge if less than 5 years premiums have been paid. The amount of this charge depends on the term of the contract, the premiums paid and the type of commission paid.

This charge may also be applied if premiums are stopped or reduced before maturity.

- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were open to new business in SALAS before the transfer date and continued to be issued by SAL until April 2001.
- (l) The policy charge increased from £1.82 to £1.89 per month on 15 January 2001.

#### *(viii) Provider Income Protection*

- (a) Provider Income Protection.
- (b) This is a non-profit permanent health insurance contract.
- (c) Regular (annual or monthly) premium.
- (d) This contract is designed to provide replacement income benefit in the event of the policyholder being totally unable through sickness or accident to continue with his/her own occupation, and not following any other. Reduced benefits can be payable under certain conditions where the incapacity is not total.

The contract is written to a specified expiry age (which may be 50, 55 or any age from 60 to 65 inclusive). At the expiry date of the contract, the value at the bid price of the allocated units remaining is payable to the policyholder.

In the event of a claim, the income benefit commences after a deferred period of 13, 26 or 52 weeks.

Premiums are waived during the period of income benefit payments.

The benefit payable on death is the greater of the sum of premiums, including any extra premiums due to a rating, payable in the first year of the plan and the value at the bid price of the units allocated at the date of death.

- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by using a nil initial allocation factor for 48 months.

Renewal expenses and renewal commission are met from a monthly policy charge, the annual management charge and a combination of the allocation factor and the bid/offer spread.

The cost of the Income Protection benefit is met by the monthly cancellation at the bid price of sufficient units to meet the cost for that month.

The annual management charge is currently 0.25% per annum.

**5.(1)(D) Description of SAA linked contracts continued**

- (g) Increases in policy charges are normally restricted to increases in line with inflation except where it can be demonstrated that costs have increased by more than this. There are no restrictions on increases in the annual management charge other than that imposed by the need to meet policyholders' reasonable expectations.

The rates used to calculate the charge for Income Protection benefit may be changed if there is a significant change in the expectation that the Company's policyholders will suffer an accident or illness which leads to a claim.

- (h) The plan has no surrender value.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) This contract was closed to new business on the transfer date.
- (l) There were no increases in the rates of charges during the report period.

**(ix) Wealth Preservation Bond**

- (a) Wealth Preservation Bond.
- (b) These bonds consist of a non-profit endowment assurance and a non-profit whole life assurance.
- (c) Single premium.
- (d) The Wealth Preservation Bond was designed for Inheritance Tax planning. It enables the investor to gift capital to beneficiaries whilst retaining access to the income the capital generates.

Units in the Wealth Preservation Capital Fund are allocated to the whole life policy. The same number of units is allocated to the endowment assurance policy. The death benefit under the whole life assurance is a percentage of the bid value of units. The percentage varies with duration in force as follows:

Duration in force (years)	Percentage
1	92.5
2	94.0
3	95.5
4	97.0
5	98.5
6 and over	100.0

Income from the assets comprising the Wealth Preservation Capital Fund is accumulated in the Wealth Preservation Income Fund, units of which are allocated to the endowment assurance policy. The income is distributed every quarter on 1 March, 1 June, 1 September and 1 December and is used to allocate cash fund units to the endowment assurance policy. Policyholders can elect to receive all or part of the income immediately as a partial withdrawal from the policy. Any income not taken immediately is redirected into up to three internal linked funds available for this purpose. The endowment policy's death benefit is £100 plus the amount of any accrued income not yet distributed (i.e. the value of the Income Fund units) plus the bid value of units in other funds purchased by redirected distributions.

#### 5.(1)(D) Description of SAA linked contracts continued

The endowment assurance matures on the anniversary following the policyholder's 105th birthday. The maturity benefit is the amount of any accrued income not yet distributed plus the bid value of units in other funds purchased by redirected distributions plus the bid value of its Wealth Preservation Capital units.

- (e) Not applicable.
- (f) Acquisition expenses and initial commission are recouped by an establishment charge of 1.25% per annum of the funds for the first five years of the policy. The charge is met by monthly deallocation of units.

The bond is sold on various commission terms: full initial commission, full fund-related commission or part initial and part fund-related commission. Where full or part fund-related commission is selected, higher allocation rates apply and the fund-related commission is met by a quarterly service charge taken by deallocation of units from the whole life policy.

Renewal expenses are met by the annual management charge.

If initial commission has been rebated, the premium deemed to be invested after taking account of the allocation factor may be greater than the amount of the premium. Any such enhancement is met from establishment charges.

The annual management charge for the Wealth Preservation funds is currently 0.75% per annum. If an investor has chosen to redirect income, the annual management charge will be that appropriate to the fund in which the redirected units are held.

- (g) The annual management charge may be increased only if administration costs have increased by more than the rate of inflation and only to an extent consistent with the need to meet policyholders' reasonable expectations.
- (h) These bonds cannot be fully surrendered. Distributions and withdrawals may be taken from the endowment assurance.
- (i) Linked benefits under these contracts are wholly reinsured with Scottish Amicable Life plc who refund the whole of the annual management charge. Benefits are determined by reference to the value of internal funds of the reinsurer.
- (j) Not applicable.
- (k) These contracts were closed to new business on the transfer date.
- (l) There were no increases in the rates of charges during the report period.

**5. (1)(E) Europe linked contracts**

***Prudential Europe Vie***

- (a) Prudential Europe Vie.
- (b) These contracts are whole life assurances. They may include non-linked benefits as described in 4(A)(a)(1)H (page 13).
- (c) These are single premium assurances. Additional top up premiums may be paid at any time.
- (d) The death benefit is the value of the units on the day the death claim process is complete.
- (e) There are no guaranteed investment returns.
- (f) Costs are recovered from policies by the following charges:
  - (i) An initial charge of 4.5% of the premium, including any top-up premiums.
  - (ii) An annual management charge of 0.75% of the bid value of the units.
  - (iii) Exit charges applied to withdrawals (other than regular withdrawals) at the following rates:

Year of exit	Charge as % of fund value
1	2
2	2
3	1
4 and over	0

- (g) None of the charges described in (f) above can be increased.
- (h) The surrender value is the value of the units at the date of surrender, less an early discontinuance charge shown in (f)(iii) above.
- (i) Benefits are linked to the Réactif or Carmignac Investissement UCITS funds managed by Véga Finance and Carmignac Gestion respectively.
- (j) Not applicable.
- (k) The contract was opened to new business during the year to the valuation date.
- (l) Charges cannot be increased.

## 5. (1)(F) Hong Kong linked contracts

### (i) *Linked assurances*

This category comprises two products, PruLink and PRUretirement.

#### (I) *PruLink*

- (a) PruLink.
- (b) These contracts are whole life assurances.
- (c) Regular premiums may be paid yearly, half-yearly, quarterly or monthly. Additional top up premiums, single or regular, may be paid at any time.
- (d) At issue, there is a choice of benefit payable on death before age 65. The benefit may be either the sum assured *plus* the bid value of units allocated to the policy, or the *greater* of the sum assured and the bid value of the units. After age 65, the benefit is the bid value of units.
- (e) Provided regular premiums are paid when due and no partial withdrawals are made which cause the fund to fall below a minimum level set by the Company from time to time, the sum assured is guaranteed to be payable on death before age 65 (75 for some policies issued before 2000) irrespective of the performance of the units.
- (f) An administration charge and a mortality charge are levied monthly by cancelling units at the bid price. Additional charges are levied on premiums and on the funds. Current charges are as follows:

#### **Premium charge:**

Year	Charge
	%
1	100
2	40
3-10	10
11 and over	5

The current charge for top-up premiums is between 4% and 5% depending on the size of the premium.

**Administration charge:** US\$4 per month starting from the beginning of the second policy year.

#### **Management charge:**

The charge is 1% per annum of the value of the fund assets for the Global Growth Fund and the US\$ Bond Fund and 1.25% per annum for the Global Equity Fund and the Pacific (ex-Japan) Fund. Other recurring fees may not exceed 0.125% per annum of the value of these funds' assets except for the Pacific (ex-Japan) Fund where the maximum is 0.25%.

The charge for the Prudential Money Fund is not more than 0.5% per annum of the value of the fund assets.

- (g) All charges are subject to revision without limit upon three calendar months prior written notice to the policyholders, provided any increase is consistent with policyholders' reasonable expectations. The Company reserves the right to levy other policy administration charges, for example on surrender.
- (h) The surrender value is currently the cash value of the units allocated to the policy.
- (i) Benefits are linked to internal linked funds.
- (j) Not applicable.

**5.(1)(F) Description of Hong Kong linked contracts continued**

- (k) The contract was open to new business on the valuation date.
- (l) There were no increases in the rates of charges during the report period.

**(II) PRUretirement Plan**

- (a) PRUretirement Plan.
- (b) These contracts are limited premium whole life assurances with a waiver of premium benefit.
- (c) Regular premiums may be paid yearly, half-yearly, quarterly or monthly. Additional top up premiums, single or regular, may be paid at any time.
- (d) The death benefit is 101% of the value of the units or, if greater, 100% of total premiums paid less any withdrawals.

If the policyholder becomes incapable of following any occupation, all premiums due after 180 days of incapacity up to age 65 are waived.

At issue, the policyholder chooses a selected retirement age at which contractual regular premiums cease. On attaining that age, bonus units are added to the policy at the following percentage of the annual premium payable multiplied by the complete number of years for which it has been paid:

Number of years	%	Number of years	%
10-12	2	30-34	7
13-15	3	35-39	8
16-19	4	40-44	9
20-24	5	45- 49	10
25-29	6	50 or more	11

- (e) There are no guaranteed investment returns.
- (f) An administration charge and a waiver of premium charge are levied monthly by cancelling units at the bid price. Additional charges are levied on premiums and on the funds. Current charges are as follows:

**Premium charge:**

Year	Charge
	%
1	75
2-8	10
9 and over	0

The current charge for top-up premiums is between 4% and 5% depending on the size of the premium.

**Administration charge:** US\$4 per month starting from the beginning of the second policy year.

**Management charge:**

The charge is 1% per annum of the value of the fund assets for the US\$ Bond Fund and 1.25% per annum for the Global Growth Fund, Global Equity Fund and the Pacific (ex-Japan) Fund. Other recurring fees may not exceed 0.125% per annum of the value of these funds' assets except for the Pacific (ex-Japan) Fund where the maximum is 0.25%.

The charge for the Prudential Money Fund is not more than 0.5% per annum of the value of the fund assets.

#### 5.(1)(F) Description of Hong Kong linked contracts continued

- (g) All charges are subject to revision without limit upon three calendar months prior written notice to the policyholders, provided any increase is consistent with policyholders' reasonable expectations. The Company reserves the right to levy other policy administration charges, for example on surrender.
- (h) The surrender value is currently the cash value of the units allocated to the policy.
- (i) Benefits are linked to internal linked funds.
- (j) Not applicable.
- (k) The contract was open to new business on the valuation date.
- (l) There were no increases in the rates of charges during the report period.

#### (ii) *Global Growth Fund*

- (a) Global Growth Fund.
- (b) These are group provident fund contracts.
- (c) Single or regular yearly, half-yearly, quarterly or monthly premiums may be paid.
- (d) When a scheme member retires, dies or leaves service, the bid value of units allocated to his or her account is payable.
- (e) Not applicable.
- (f) An annual expense charge is payable. Excess initial costs are recovered from subsequent years' charges and from a surrender charge payable on scheme termination during the first five years.

The expense charge during the report period was:

HK\$1,000 per scheme, plus

HK\$12 per member for the first 500 members and HK\$10 for each additional member, plus

a contribution-related charge of 3% of the first HK\$200,000 reducing on a sliding scale to 0.9% on the excess over HK\$1,000,000.

The unit trust manager levies a management fee of 1% per annum and a trustee fee of 0.125% per annum.

- (g) The Company may increase the charges on any scheme anniversary after the third, subject to six months notice being given, provided any increase is consistent with policyholders' reasonable expectations.
- (h) On scheme termination a surrender charge, initially 5% of the bid value of units reducing linearly to zero at the beginning of year 6, is payable. No charge is made when an individual member leaves the scheme.
- (i) Benefits are determined by reference to the value of units in a unit trust.
- (j) Not applicable
- (k) The contract was open to new business on the valuation date.
- (l) There were no increases in the rates of charges during the report period.

## 5. (2) With-profits options

With-profits options are available under the following contracts described in 5(1)(A)-(F) above:

- (A) Prudence Bond, Prudence Managed Bond, PPA, EPP2/3/4, EIB, PPP, FSAVC, GPP1/2/3/4, MPP2, PTP, AVC, Flexible Retirement Income Account;
- (C) IPA, FlexiPension Series 2 to 7, MaxiPension Series 1, 2 and Plus, OmniPension Series 1, 2 and Plus, ExtraPension Series 1, 2 and 3, IndePension Series 1 to 5, Section 32 Buy-Out, Phased Retirement and Income Drawdown Plan.
- (D) Home Purchaser Series 2 and 3, Amicable Savings Plan;
- (E) Prudential Europe Vie

The additional information required is given in the appropriate parts of 4(A) – 4(D) above.

## 5. (4) Unit pricing methods

### (i) *Prufund*

Unit pricing is based on the smoothed equity approach (as defined by the 18 November 1993 report of a Working Party of the Society of Actuaries in Ireland). The fund is invested both directly and through unit trust holdings. No new business other than top ups has been written since 1991. The portfolio is therefore in long term decline. The bid price is set equal to the cancellation price, with a bid/offer spread of 4%. Prices are calculated weekly, with transactions carried out on a forward pricing basis. Unit prices are rounded by up to 0.1p in the favour of the Company. Brokerage fees are charged to the fund using rates notified by the fund manager, M&G Investment Management Limited.

The cancellation price is the cash amount for which the assets of the unit fund can be sold, net of all costs that would be incurred in disposing of the assets, divided by the number of units in existence.

Where investments are in Prudential Unit Trusts, the purchase price is the underlying creation price and stamp duty charge while the sale price is the underlying cancellation price.

### (ii) *Hong Kong PruLink policies - all funds except the Prudential Money Fund*

The funds are wholly invested in similarly-named authorised Guernsey unit trusts managed by Prudential Fund Managers Guernsey. Units are allocated or cancelled on the next weekly valuation date at the prices determined by the unit trust manager. There is no bid/offer spread. PruLink policies provide that the fund unit prices may be varied from the corresponding unit trust price if a variation would be justified by, for example, a change in the basis of Hong Kong life office taxation.

### (iii) *Hong Kong PruLink policies - Prudential Money Fund*

The unit issue price and redemption price are always 1.000. Interest is credited to policies in the form of additional units not less frequently than once a month. The rate to be credited is determined from the value of the fund assets, any surplus being distributed by issuing new units on a pro-rata basis.

### (iv) *Others*

The unit pricing methods for all other contracts are described in the regulatory returns of the companies with which the linked liabilities are wholly reassured.

## 5. (5) Provisions for capital gains tax

### (i) *Prutrust*

Capital gains tax is not allowed for in the unit price. On claim or surrender, a deduction is made equal to the full rate of capital gains tax applied to indexed gains which have occurred over the lifetime of the policy. As the units are invested wholly in the UK Growth Trust, capital gains tax is actually paid on a deemed disposal basis. The Company holds a capital gains tax reserve equal to the outstanding instalments of tax on the deemed disposal basis, less the capital gains tax which will be deductible from policyholder units. This reserve is invested in units and other shareholder assets.

### (ii) *Prufund*

The capital gains tax reserve on 31 December 2001 was equal to 22% of unrealised indexed gains on other than unit trust holdings, plus an allowance of 19.44% of the taxable gains applicable to the deemed disposal of any unit trust holdings; this reserve is a deduction from the unit fund and is therefore reflected in the unit price. Realised gains were taxed at 22%. When a gain is realised an appropriate transfer is made from the linked funds to the trading account; similarly a transfer is made at the year end in respect of the tax liability arising from deemed disposals.

### (iii) *Guaranteed Equity Bond*

Liabilities are matched by a combination of bonds and derivatives which ensure that at maturity the gross amount payable less tax at 22% on the chargeable gain from the derivatives equals the guaranteed maturity benefit. Capital gains tax is allowed for in the valuation by including the gross value of the derivatives in the mathematical reserves.

### (iv) *Linked contracts in France and Hong Kong*

The funds are not subject to capital gains tax.

### (v) *Prudence Bond, Prudence Managed Bond, Prudential Distribution Bond, linked contracts in SAA*

A full description of the capital gains tax provisions for these contracts can be found in the regulatory returns of the companies with which the linked liabilities are wholly reinsured.

### (vi) *Others*

The funds all relate to pension business and are not subject to capital gains tax.

## 5. (6) Discounts on unit trust purchases

### (i) *Prutrust*

The Company buys units of the Prudential UK Growth Trust at a discount of 3% from the published offer prices. In all other respects the conditions of sale and purchase are the standard conditions applied by Prudential Unit Trusts Limited.

### (ii) *Prufund*

The fund buys units of the Prudential UK Growth Trust and the Prudential Small Companies Trust at the creation price and sells back at the cancellation price. The fund also benefits from a rebate of the annual management charge.

### (iii) *France*

The company receives rebate commission of 0.6% p.a. of funds under management from the Réactif and Carmignac external unit-linked funds. Corresponding rebate commission of 0.4% and 0.3% respectively is payable to distributing agents. Policyholders do not benefit from this rebate.

### (iv) *Hong Kong*

No special terms apply when units are purchased from the unit trust manager.

### (v) *Others*

The unit pricing methods for all other contracts are described in the regulatory returns of the companies with which the linked liabilities are wholly reassured.

## 6. Valuation - principles and methods

- (1) (i) Unless specified to the contrary in (x) below, the mathematical reserve for assurances and annuities reported in Form 51 is the difference between the present value of the benefits and the present value of the future valuation net premiums, both calculated with provision for immediate payment of claims. Contracts with a common attained age and number of years to run to maturity or premium cessation are grouped together, except where it is necessary to value individually to eliminate negative reserves (see 6(1)(d) (page 86)).
- (ii) The mathematical reserve for accumulating with-profits business in SAIF and SAA, and accumulating with-profits business accepted as reinsurance from SAL, is taken as the lower of:
- (a) the value at the bid price, excluding terminal bonus, of the notional number of units allocated to policyholders, and
  - (b) the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date,

or, if greater, the value of the guaranteed liabilities, excluding terminal bonus, calculated on a gross premium bonus reserve method based on charges.

A further non-unit reserve is held in respect of mortality or morbidity, as appropriate, and expenses (including investment management expenses and other outgo associated with payments to third parties).

The comparison of the value of units allocated, the surrender or transfer value and the bonus reserve liability is carried out on a policy-by-policy basis.

For contracts for which the product description indicates that initial expenses are recouped by a shortfall charge, an annual establishment charge, a recurrent management charge or an additional management charge, the value of the units is net of the present value of those future charges.

In the base scenario the surrender or transfer value is taken as the accumulated fund, including terminal bonus, at the valuation date, less any explicit charge that would apply on immediate surrender. In the resilience scenarios, the surrender or transfer value described above is, where appropriate, reduced to reflect the market value reductions that would be applied consistent with movements in the underlying asset values over the lifetime of the policy.

The bonus reserve liability makes due allowance for future reversionary bonus interest at rates which would be payable if the valuation assumptions were borne out in practice and having regard to policyholders' reasonable expectations.

The non-unit reserves are adequate, on the valuation basis, to eliminate any future negative cash flows which would otherwise arise.

Specific provision is made for the Guaranteed Minimum Pension under Section 32 Buy Out contracts.

- (iii) The mathematical reserve for all other accumulating with-profits business is taken as the lower of:
- (a) the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding terminal bonus, and
  - (b) the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date,

or, if greater, the value of the guaranteed liabilities, excluding terminal bonus, calculated on a gross premium bonus reserve method.

The comparison of the accumulated fund or value of units allocated, the surrender or transfer value and the bonus reserve liability is carried out on a policy-by-policy basis.

## 6. Valuation – principles and methods continued

For contracts for which the product description indicates that initial expenses are recouped by an annual cancellation of units allocated in the first year, the number of units valued is reduced appropriately. In cases where a higher benefit would be payable on early death, due allowance has been made.

In the base scenario the surrender or transfer value is taken as the accumulated fund, including terminal bonus, at the valuation date, less any explicit charge that would apply on immediate surrender. In the resilience scenarios, the surrender or transfer value described above is, where appropriate, reduced to reflect the market value reductions that would be applied consistent with movements in the underlying asset values over the lifetime of the policy.

The bonus reserve liability makes due allowance for future reversionary bonus interest at rates which would be payable if the valuation assumptions were borne out in practice and having regard to policyholders' reasonable expectations.

Where relevant, additional reserves have been set up for mortality, outstanding premiums, premiums in respect of policies not yet accepted and adjustments to allow for the incidence of initial commission. For Bond 32 the mathematical reserve has been increased where necessary to ensure that it is not less than the value, at 4%, of the GMP.

- (iv) The mathematical reserve for property-linked contracts consists of a unit liability together with a non-unit liability to cover expenses, mortality, morbidity, options and guarantees and, for Prustrust, capital gains tax.

The unit liability is based on the value at the date of valuation of the units allocated to policyholders and, for the Prufund Investment Bond, on the value of the units held as part of the death benefit in excess of the units so allocated. Unit liabilities are wholly reassured under all contracts except Prustrust and Prufund in the UK and all overseas linked business.

The non-unit liability for mortality and expenses is determined by a discounted cash flow method, on a worst case basis as far as future conversion to paid-up status is concerned, and is adequate on the valuation basis to ensure that any future negative cash flows which would otherwise arise are eliminated. Part of the available fund charge is reserved for funding the death benefit for the Prufund Investment Bond. Specific reserves are also set up for tax on capital gains, for outstanding premiums and, where relevant, for premiums received in respect of policies not yet accepted.

- (v) The mathematical reserve for RPI linked annuities is determined without an explicit allowance for future increases in annuity payments, which is consistent with the treatment of the matching assets.
- (vi) The mathematical reserve for the index-linked Guaranteed Peak Bond is the value of the underlying asset which exactly matches the unit liability.
- (vii) The mathematical reserve for the index-linked Guaranteed Equity Bond is the value of the guaranteed minimum maturity amount plus the gross value on the valuation date of the derivatives required to meet the additional maturity amount net of tax on gains.
- (viii) The mathematical reserve for guarantees issued under the FSA personal pensions review is calculated by valuing the pension scheme benefits to which the policyholder would otherwise have been entitled and subtracting the value of the personal pension policy. In the absence of information about the actual scheme benefits, each policyholder where relevant is assumed to be in a scheme providing an RPI-linked pension of two thirds of final earnings after 40 years' service with a 50% continuation to a surviving spouse and equivalent death-in-service benefits.

## 6. Valuation – principles and methods continued

- (ix) The mathematical reserve for guaranteed annuity options is based on a 100% take-up of available options, and is determined as follows:

(I) CA and CAAVC

For valuation purposes, it is assumed, in line with current practice, that if the guaranteed rates are higher than current rates on the valuation date, the guarantee will be revised with 6 months' notice from the next scheme renewal date. As a result, it is assumed that on average a further 18 months' premiums will be subject to the guarantee prior to its amendment. The additional amount of annuity payable as a result of the guarantee is calculated assuming that the recent profile of retirements (age, sex and purchase money) continues. The resulting annuity is valued on the basis used for non-profit group deferred annuities.

(II) EPP Mark 1

The fund in respect of the first 5 years' premiums for each scheme is calculated. The additional amount of annuity payable as a result of the guarantee is then calculated and valued as described in (I) above.

- (III) SAIF products - FlexiPension Series 1 (including investments written as FlexiPension Series 2 or Series 1 pensions)  
Individual Endowment/Pure Endowment - Series 1 & 2  
IPA

For accumulating with-profits and linked business, an additional reserve is calculated by rolling up the existing unit reserve with future premiums to the selected retirement date, and calculating the present value of the excess of the annuity guarantee over the projected fund value. For linked business, the projected fund is calculated assuming a fund growth rate of 6.625% (i.e. 7.5% less an annual management charge) and the present value of the annuity guarantee is calculated at a discount rate of 4.5%. For accumulating with-profits business, no future bonus is allowed for. The projected fund is calculated assuming zero growth, and the present value is calculated at a zero discount rate.

For other business, the benefit included in the net premium reserve is the greater of the cash benefit and the value of the annuity guarantee. The mortality basis in possession is 70% of PMA92 (c=2002) or 70% of PFA92 (c=2002). Allowance is made for mortality improvement in deferment by reducing the valuation interest rate in deferment by 0.35%. The valuation interest rate (before the 0.35% reduction for mortality improvements) is 5% for FlexiPension and 4.5% for other products in deferment, and 4% in possession.

In addition a separate expense reserve is held.

- (x) Exceptions to the above are as follows:

Mathematical reserves for with-profits whole life assurances issued by the Company prior to 1978, are calculated on the assumption that each policy is converted on its next anniversary to an endowment assurance maturing after ten years, this being the most onerous option.

A specific provision is held for the guarantee on certain low-cost endowment assurances described in the final paragraph of 4(A)(c)B (page 17).

An additional reserve is held against possible adverse mortality experience arising from the exercise of options under convertible term assurances in SAIF.

Specific provision is made for guaranteed early maturity options under Flexidowment and certain other miscellaneous assurances and deferred annuities in SAIF, and for early maturity options and annuity options under FlexiPension (Series 1) contracts, by valuing them at the earliest maturity option date and holding additional reserves for maturity options thereafter. For FlexiPension (Series 1), the 3% Zillmer adjustment described in paragraph 6(1)(c) (page 86), which applies to the maturity benefit at the earliest maturity option, is reduced to 2% of the maturity benefit at later ages.

Specific provision is made for guaranteed cash options under pension assurance and pure endowment contracts in SAIF by valuing the greater of the cash option and the present value of the annuity benefit.

## 6. Valuation – principles and methods continued

The mathematical reserve for waiver of premium benefits on contracts in SAA and SAIF is two years' premium income plus a reserve for claims in payment.

The mathematical reserve for group deferred annuity contracts in SAIF is the value as at 31 December 2001 of the benefit secured before the 2001 renewal date, plus the value of the return of premiums on death before pension age. An additional reserve is held for premiums received on or after the 2001 renewal date and for refunds of premiums outstanding.

The reserve for single premium loan protection policies is the unearned premium plus any accrued profit commission. The unearned premium is net of initial commission but gross of all other loadings for expenses and profit. No additional reserve is held against adverse deviations in mortality experience since the expense and profit loadings are large in relation to the underlying net premium.

The mathematical reserve for certain minor classes of assurance and contingent reversionary annuities is based on the premiums paid, and is not less than an appropriate reserve calculated prospectively.

Deferred assurances and deferred annuities where the death benefit is the return of the premiums paid are valued without allowance for mortality during the period of deferment.

The mathematical reserve for some individual deferred annuities is obtained by accumulating the premiums paid at the greater of a rate of interest guaranteed at the date of issue and a concessionary rate of interest declared for each year, these concessionary rates being the rates of interest used in determining the benefits payable.

- (xi) Where the Company has accepted liability for future payments of Life Assurance Premium Relief on policies which were in the course of issue and subsequently not allowed as eligible following the Finance Act 1984, provision for the full liability is made explicitly in the mathematical reserves for both linked and non-linked contracts issued by PAC. For contracts issued by SALAS, appropriate provision is included in the additional reserves in SAIF, as described in 6(1)(i) (page 88).

### **In particular, the following principles and methods have been adopted:**

- (a) In determining the long term liabilities, allowance has been made for derivative contracts and contracts or assets having the effect of derivative contracts, by adjusting the existing assets attributed to the long term business to reflect the underlying investment exposure.
- (b) Due regard has been paid to the reasonable expectations of policyholders as follows:

For the declaration of annual reversionary bonuses on conventional with-profits business, by adopting a valuation interest rate which is less, by an amount which makes implicit provision for the emergence of appropriate future reversionary bonuses, than that element of the total future investment return which, it is anticipated, will be utilised in the declaration of reversionary bonuses. In all cases, the mathematical reserve is not less than any surrender value which a policyholder might reasonably expect to receive, excluding any element relating to terminal bonus.

For accumulating with-profits business, the surrender or transfer value payable at the valuation date, and the bonus reserve liability, make direct allowance for policyholders' reasonable expectations. Where mathematical reserves are based on the accumulated fund or value at the bid price of the units allocated, the method allows investment earnings in excess of any guaranteed rate of accumulation and an amount needed to provide for expenses, to emerge in proportion to reserves and hence (to the extent that they are not utilised to provide for future terminal bonus) fund bonus interest.

For linked business the Company reserves the right to increase the annual management charge applicable to certain internal linked funds. Policyholders would reasonably expect that any such increases would be associated with external events outside the control of the Company or, in the case of policies transferred from SALAS, with an increase in management expenses considerably in excess of inflation. The calculation of non-unit reserves is in accordance with this expectation.

## 6. Valuation – principles and methods continued

- (c) The net premium method has been used without modification for non-profit assurances issued in the United Kingdom, and for non-profit individual deferred annuities. All other assurances, and with-profits individual retirement annuities, have been valued by the modified net premium method.

For assurances valued by the modified net premium method, the net premium is modified by adding an amount having a capitalised value at the date of issue of the policy of:

- (A) 1.5% of the sum assured for business issued in Malta;
- (B) 2% of the sum assured for pensions assurance policies in SAIF; and
- (C) 3% of the sum assured for all other policies.

For business issued in Hong Kong and Malta, net premiums are further modified to ensure that they do not exceed the unmodified net premium which would apply if the policy had been issued one and a half years (Hong Kong Better Life policies) or one year (other policies) after its actual issue date, the dates of payment of the sum assured and cessation of premiums being unchanged.

For with-profits individual retirement annuities, the addition is 2% of the relevant capital sum.

For contracts in SAIF, the amount of each net premium is limited where necessary to 92.5% of the premium actually payable by the policyholder.

These modifications conform with rule 5.10 of IPRU (INS).

- (d) To ensure conformity with rule 5.15 of IPRU (INS), policies where negative reserves could arise have been valued individually, and the mathematical reserves increased to zero where necessary. Appropriate provision has been included within the additional reserve to ensure that outstanding premiums do not result in any policies being treated as an asset.
- (e) For with-profits assurance policies issued by PAC where premiums have ceased, allowance is made for future reversionary bonuses at a rate of 1% per annum simple.

For accumulating with-profits business, the bonus reserve liability makes allowance for future reversionary bonuses.

Otherwise, no specific allowance is made for future bonus.

- (f) The fund shown in Form 58 relates to assets at book value. No provision for any prospective liability for tax on unrealised capital gains in respect of non-linked business has been included in the mathematical reserves shown in Form 58. However, a provision is made in Form 14 as described in section 6(2) below.

For Prutrust policies, the reserve for tax on capital gains shown in Form 53 has been calculated on the assumption that all units were realised at 31 December 2001, with due allowance for the future deductions which would be available from policy proceeds.

For Prufund policies, unit prices are calculated net of a provision for tax on capital gains.

For Guaranteed Equity Bond a provision for tax on capital gains is included in the mathematical reserves.

For Prudence Managed Bond, Prudence Distribution Bond, linked benefits under Prudence Bond and all property-linked contracts in SAA and SAIF, reserves for any capital gains tax liability arising on the sale of units are maintained by the reinsurer.

## 6. Valuation – principles and methods continued

- (g) Provision is made in the bonus reserve valuation for the guaranteed accumulation rates under United Kingdom deposit administration contracts which are described in 4(A)(a)(1)C (page 7).

For contracts in SAIF and SAA, the following investment performance guarantees apply :-

- (i) The rate of interest credited to a group accumulation policy will not fall below 5% per annum in the first five years of the policy's duration.
- (ii) The value of accumulation units in the Net Cash Fund, Exempt Cash Fund and Exempt Building Society Fund will not fall.
- (iii) For accumulating with-profits pensions policies where the application was received before 15 January 1996, the value of Exempt With-Profits (Series 1) initial units is guaranteed not to fall and the increase in value of Exempt With-Profits (Series 1, 2, 3 and 4) accumulation units is guaranteed to average not less than 4% per annum over the term of the policy. The guarantee applies only on maturity or earlier death.
- (iv) The value of Guaranteed Investment Bonds on the guarantee dates is guaranteed to be at least 110% of the original investment.

No specific provision is made for the guarantees in (i) and (ii) above. The guarantees in (iii) are allowed for in the bonus reserve valuation. Provision for the guarantee in (iv) is met by the purchase of appropriate put options.

## 6. Valuation – principles and methods continued

(h) Specific provision is made for certain options under which policies may be effected without evidence of health.

(i) The additional reserve covers:

the expenses associated with carrying out the FSA personal pensions review and the potential costs of compensating policyholders other than those in phase 1 who have accepted guarantees;

the expenses associated with carrying out the FSAVC review and the potential cost of compensating policyholders;

the £34m cost of meeting the guaranteed annuity options that were granted on pensions policies issued by PAC in the 1970s and 1980s, the equivalent provision of £758m in SAIF being included in the mathematical reserves for the appropriate policies;

future expenses likely to be incurred in fulfilling ex-Scottish Amicable contracts, to the extent that such expenses cannot be met by the margin between the actual premium receivable and the net premium valued;

potential additional liabilities in respect of systems and administration errors;

the potential cost of meeting maturity options and miscellaneous guarantees;

life assurance premium relief paid by the Company on ex-Scottish Amicable contracts (appropriate provision for other policies being made within the mathematical reserves);

claims incurred but not reported at the valuation date;

additional mortality costs as a result of AIDS (except for ex-Scottish Amicable assurances where provision is made in the mathematical reserves);

early cessation of premiums under UK assurance policies (other than those in the pension fund and those transferred from Scottish Amicable) issued after 1962;

ensuring that outstanding premiums and, in Hong Kong, outstanding commission do not result in a contract being treated as an asset;

potential levies to the Financial Services Compensation Scheme; and

general contingencies.

(2) For business in the linked fund, explicit provision is made in respect of mismatching and the prospective liability for tax on unrealised gains. For other business, the funds are brought into Form 58 at book value. No provision is made in the valuation for mismatching or the prospective liability for tax on unrealised capital gains, both such provisions being made in Form 14. For the Other Long Term PAC Fund, the provision in Form 14 for the prospective liability for tax on unrealised capital gains is based on all UK ordinary branch business other than property-linked and all industrial branch business combined, and has been assessed by providing an amount equal to 22% of the estimated chargeable gains at 31 December 2001. For SAIF, the equivalent amount is 22% of the estimated chargeable gains at 31 December 2001.

The provision for mismatching is as described in 7 below.

## 7. Interest, mortality and morbidity bases, resilience etc

- (1) The rates of interest and tables of mortality assumed in the valuation are shown in Forms 51 to 54. For Better Life contracts in Hong Kong, the valuation interest rate is 4% for the with-profits portion and 4.5% for the non-profit portion. The valuation interest rates make implicit provision for £174m per annum of investment management expenses that relate to maintenance and lease costs on property assets. The yields on property shown in Forms 48 and 57 are net of these costs.
- (2) Specimen rates per £1,000 sum at risk for the incidence of death, terminal illness and critical illness combined used to value MPCIC are:

Age	Men		Women	
	non-smokers	smokers	non-smokers	smokers
20	1.10	1.10	0.60	1.30
25	1.20	1.20	0.90	1.20
30	1.00	1.10	1.30	1.40
35	1.20	1.70	1.50	2.20
40	1.70	3.00	1.90	3.60
45	2.70	5.40	2.70	6.20
50	5.30	9.70	4.60	10.30
55	9.80	16.20	7.70	15.90
60	17.90	27.30	12.60	24.70
65	29.50	40.70	17.80	33.80

The underlying mortality rates are AM92 or AF92 ultimate both rated up 1 year.

Specimen incidence rates per \$1,000 sum at risk used to value accelerated critical illness benefit and total and permanent disability benefit attached to with-profits and linked assurances issued in Hong Kong are:

Age	Critical illness		TPDB
	Men	Women	
20	0.90	0.35	0.063
25	0.82	0.54	0.072
30	0.72	0.78	0.081
35	0.93	1.19	0.108
40	1.49	1.79	0.171
45	2.58	2.76	0.270
50	4.31	4.28	0.423

Age	Critical illness		TPDB
	Men	Women	
55	6.87	5.92	0.702
60	11.50	8.20	1.206
65	17.08	11.34	2.016
70	22.54	15.87	2.889
75	28.85	21.14	2.889
80	32.28	25.05	2.889
85	34.00	25.11	2.889

No other unpublished mortality or disability tables have been used.

- (3) The mortality and disability tables used are based on experience relevant to the State of the commitment.
- (4) In general, annuities are valued using various percentages of the 92 series tables for annuitants and pensioners. The percentages are selected so that the valuation makes allowance for future mortality improvement at a faster rate than that implicit in the underlying tables. Due to practical constraints, immediate annuities issued in Hong Kong are valued on the 80 series tables with prudent allowance for improvements in mortality. For annuity contracts in deferment, for valuing the provision for guaranteed annuity options on SAIF policies and for guarantees issued in connection with phase 1 of the FSA personal pensions review, a further deduction of 0.35% from the valuation rate of interest has been made to allow for mortality improvements prior to vesting.
- (5) Provision for AIDS has been assessed using one third of the additional mortality derived from the assumptions underlying projection R6A of the Institute of Actuaries Working Party Bulletin No. 5.

For business in SAIF and SAA and reinsurance accepted from SAL, the provision is made by modifying the mortality table used to calculate the mathematical reserves.

For other business, provision is made by including £2.87m in the additional reserves. No allowance has been made for Prufund Protection Plan because mortality charges can be varied.

## 7. Interest, mortality and morbidity bases, resilience etc continued

- (6) To ensure compliance with rule 5.17 of IPRU (INS), the following scenarios of future changes in the value of a block of assets equal in market value to the total mathematical reserves (after distribution of surplus) have been tested. The resulting value of the assets has been compared with the resulting revised values of those mathematical reserves. Allowance has been made in each scenario for the effect on the prospective liability to tax on unrealised capital gains. The scenarios tested are:
- (a) A combination of
    - (i) a 10% fall in equity and property values with corresponding rises in dividend and rental yields,
    - (ii) for fixed interest securities
      - of less than five years outstanding term to redemption (including short term deposits), a 20% fall in the risk free yield
      - of fifteen or more years outstanding term to redemption, a 10% fall in the risk free yield
      - of more than five but less than fifteen years outstanding term to redemption, a fall in the risk free yield of  $(25 - \{\text{outstanding term in years and part years}\})\%$ , and
    - (iii) a 25% fall in the real yield on index-linked gilts.
  - (b) A combination of
    - (i) a fall in equity values of 25%, equity earnings of 10% and property values of 20% with no change in dividends and rental income,
    - (ii) for fixed interest securities
      - of less than five years outstanding term to redemption, (including short term deposits), a fall in the risk free yield to the maximum reinvestment rate permitted under rule 5.11(9) of IPRU (INS)
      - of fifteen or more years outstanding term to redemption, no change in the risk free yield
      - of more than five but less than fifteen years outstanding term to redemption, a fall in the risk free yield calculated by interpolation between the rule 5.11(9) rate at term five years and the 15-year gilt yield at duration fifteen years, and
    - (iii) a 10% increase in the real yield on index-linked gilts.
  - (c) an immediate increase of 3 percentage points in the rates of interest per annum obtainable on fixed interest securities, an immediate increase of one percentage point in the real yields on index-linked gilts, a 25% fall in the market value of equities, a 10% fall in equity earnings and a 20% fall in the market value of property, together with corresponding rises in the dividend and rental yields.

Scenario (6)(c) was the most onerous for each of the SAIF, Europe and the Other Long Term PAC Funds and the results on this basis are reported in Form 57.

- (7) The business is primarily with-profits, and no additional provision is considered necessary under rule 5.17(a) of IPRU (INS).
- (8) The fund shown in Form 58 relates to assets at book value. No provision for mismatching has been included in the mathematical reserves shown in Form 58. However a provision of £2.6 billion (£0.9 billion for SAIF and £1.7 billion for the Other Long Term PAC Fund) has been made in Form 14. This is based on all non-linked liabilities and the non-unit liabilities for linked business considered separately for SAIF and the Other Long Term PAC Fund, and was calculated as follows:
- (a) Valuation interest rates were adjusted as stated in Forms 57. In addition, for with-profits pensions individual deferred annuities other than those in SAIF and for guarantees issued in connection with the FSA personal pensions review, the rates of interest in possession in all scenarios were adjusted so that they were not greater than the maximum reinvestment rate specified in rule 5.11(9) (a) of IPRU (INS) which would apply in the relevant scenario.

No other assumptions were changed.

## 7. Interest, mortality and morbidity bases, resilience etc continued

- (b) Assets were hypothecated to liabilities as shown in Form 57. Income from these assets was restricted where necessary to ensure that no equity or property asset had a yield (before the market fall) in excess of the annual yield at 31 December 2001 on the Merrill Lynch over 10 years corporate bond index, less a risk margin of 30 basis points. This is reflected in the yields shown on Form 57.

For land and buildings, the restriction on rental income was applied after deducting from the expected gross income the expected outgo on maintenance costs and leases. This treatment is consistent with that adopted in Form 48. The outgo on property maintenance costs and leases amounted to £9,379,000 in SAIF and £161,838,000 in the Other Long Term PAC Fund. However, it should be noted that in Form 40 all investment management expenses, including those on property maintenance costs and leases, are shown as expenses.

For land and buildings, equities and fixed interest securities in the Other Long Term PAC Fund, implicit allowance was made for investment management charges by ensuring that the gross yields in Form 57 were at least 0.125% per annum higher than the corresponding valuation interest rates.

For accumulating with-profits policies, the liability in the resilience scenario is taken as the lower of:

- (a) the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding terminal bonus, and
- (b) the surrender or transfer value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date if the underlying assets had their resilience scenario values,

or, if greater, the value of the guaranteed benefits, excluding terminal bonus, calculated on a gross premium bonus reserve basis.

When calculating the surrender value in the resilience scenarios, the underlying assets used are those actually held in the company's with-profits fund, and not the assets hypothecated in Form 57.

For most other regular premium business the liability in the resilience scenarios is taken as the present value of the guaranteed benefits. In each case these liabilities are valued at the interest rates shown in Form 57.

- (c) (i) The long term liabilities excluding any provision for mismatching fell by £1.6 billion in SAIF and by £7.9 billion in the Other Long Term PAC Fund. The Form 14 provision for the prospective liability for tax on unrealised capital gains fell by £0.3 billion in SAIF and by £1.3 billion in the Other Long Term PAC Fund.
  - (ii) The assets allocated to the long term liabilities, including those backing the provision of £2.6 billion included in Form 14, fell by £2.8 billion in SAIF and by £10.9 billion in the Other Long Term PAC Fund from the values shown in Form 13.
- (9) Liabilities in each currency are covered by assets in that currency, with the exception of the small liability for contracts issued in Maltese currency where sterling assets are held. The valuation rates of interest pay due regard to the yields available on the matching assets and to policyholders' reasonable expectations.

