



A Guide to How We Manage Our With-Profits Fund



If you have a Pearl Self Employed Retirement Plan, originally taken out with National Provident Life Limited, please see the separate booklet 'A Guide to How We Manage the Pearl SERP Fund'.

Aim of this guide

This guide provides a summary of how we manage our with-profits fund.

Why this guide is important

You have a with-profits policy and as a result your money is invested in the Pearl with-profits fund. This guide is a summary of how we manage the with-profits fund and how that affects your policy.

Some of our policies allow you to invest in more than one type of fund and to switch between funds. If that is the case, this guide refers only to that part of your policy which is invested in the with-profits fund.

You may want to read this document with your annual statement. Keep it safe with your policy, as you may want to refer to both of them in future. Do not worry if you have mislaid your policy as you can complete a declaration when you claim against the policy. Please contact us in writing if your policy is lost and you need to confirm the terms and conditions.

Index

1. Introduction to the Principles and Practices of Financial Management
2. What is a with-profits policy?
3. How is the value of a with-profits policy calculated?
4. The with-profits fund and how we invest it
5. Charges and expenses
6. What the 'estate' is and how we use it
7. Guarantees and regular bonuses
8. Final bonus and how with-profits policies can cushion you from some of the ups and downs of the investment market
9. How we decide how much you get if you end your policy early
10. What type of policy do you have?
11. How we manage exposure to risk
12. Equity between policyholders and shareholders
13. How to find out more

1. Introduction to the Principles and Practices of Financial Management (PPFM)

What is the PPFM?

The PPFM explains in detail how we manage our with-profits business. The PPFM is quite a long, detailed and complex document so this guide is designed to explain the most important points to you as simply as we can. If you want to see the full PPFM you can get a copy from our website (www.pearl.co.uk) or by writing to us.

What are the Principles of Financial Management?

The principles are the philosophy on which we manage the with-profits fund. These are high-level statements that describe our long-term approach. We don't expect to change the principles often.

Some of the key principles are:

- We aim to treat all customers fairly.
- We will manage our business in a lawful and financially sound manner.
- We aim to manage the with-profits fund so that we can pay all guaranteed benefits.

We do not intend to change our approach to managing the with-profits fund. However, there are some circumstances when we might need to do so, for example to;

- Protect the financial position of the fund in adverse circumstances;
- Improve the accuracy of our methods;
- Correct any major errors;
- Ensure we comply with any changes in taxation or regulatory requirements; or
- Deal with unforeseen events that have a significant impact on the with-profits fund.

We will tell you at least three months in advance if changes are being made to the principles.

What are the Practices of Financial Management?

Practices are more specific statements. They give more detail of how we are currently managing the with-profits fund. The practices may change more often as we respond to, for example, how the economy is performing, changes in the life assurance industry or to regulatory requirements.

We will publish any changes to practices on our website and inform you in writing at the next available opportunity.

Governance arrangements

The responsibility for the management of the with-profits fund rests with the Board of Pearl Assurance Limited.

A separate With-Profits Committee provides independent verification that the processes followed are consistent with the PPFM and that decisions taken by the Board have followed due process and are consistent with the PPFM. The with-profits committee may also comment on matters relating to our commitment to treating customers fairly.



The With-Profits Committee will consist mainly of independent members.

Each year, we will produce an annual report for with-profits policyholders stating whether throughout the previous year we believe we have complied with our obligations relating to the PPFM. Attached to that report will be a separate report from the with-profits actuary. You can obtain a copy of the latest report from our website (www.pearl.co.uk) or by writing to us.

2. What is a with-profits policy?

A with-profits policy is usually a long-term investment, typically for ten years or more. Such policies are designed to provide policyholders with the opportunity of investing in a fund with a range of investments and where the full impact of changes in market value may not be immediately reflected in the value of the individual policy. With-profits policies generally provide a guaranteed minimum payout. There are different types of with-profits policy (see section 10).



3. How is the value of a with-profits policy calculated?

The value of your policy will depend on a number of factors, including:

- The number and amount of the premiums you have paid;
- The investment performance of the assets bought by the with-profits fund (see section 4);
- The charges and/or expenses deducted from your policy (see section 5);
- The value of any Estate Distribution (see section 6);
- The level of any guaranteed benefits (see section 7);
- The extent to which your policy is cushioned from the ups and downs in investment markets (see section 8).

When your policy matures we compare the value of the policy's 'asset share', plus the value of any estate distribution, with the value of any guaranteed benefits. We aim to pay you whichever value is larger. Each of these components of your policy value is described in more detail below.

What does the Asset Share of a policy mean?

'Asset Share' is a term used to describe your policy's share of the with-profits fund.

Asset Share =

- the total of all the premiums you have paid plus
- the investment returns minus
- expenses and charges made to your policy

Put simply, Asset Share is the money you have paid in, plus the investment return it has earned, less the expenses charged.

In most cases it is impractical to calculate the asset share for every individual policy in a fund. In these cases, we calculate the asset share by looking at groups of similar policies rather than individual policies.

It is our objective that policyholder payouts should be targeting their asset share. Whether you surrender your policy or hold it to maturity, we aim to pay on average your 'asset share'. When your policy matures we will compare the asset share with any guaranteed benefits. Where the guaranteed benefits are higher we will pay that amount. This may not be the case if you surrender or transfer your policy early. Your surrender/transfer value will generally be based on your asset share. Therefore, you may lose the additional value that you would have received from getting the guaranteed benefit at maturity.

4. The with-profits funds and how we invest it

The premiums paid into the with-profits fund are placed in a variety of investments. These investments give exposure to shares (often called equities), property, cash and fixed interest investments (such as government and corporate bonds). The fund may also use 'derivatives' (for example, the right to buy or sell securities at a pre-agreed price on a specific date) as an efficient way of quickly changing the investments in the fund and/or to reduce risks.

We may also invest some of the fund in 'alternative investments'. These 'alternative investments' will include a wider range of assets. The aim is to reduce the variations in investment returns and improve the overall return to the fund.

The return on these investments is used in calculating asset shares.



We aim to maximise the returns for policyholders but we must bear in mind future commitments to pay out on policies. We do not want to be forced into selling investments to meet these commitments at a time when their values are low. This is known as matching assets (investments) with liabilities (commitments to pay out on policies).

We review our investment strategy regularly as market conditions can change quickly. Investment strategy is also dependent on the financial position of the with-profits fund. This means taking into account a range of factors such as:

- The value of guarantees already given to policyholders.
- How much we need to keep in cash, or in investments that can be easily sold, in order to meet claims in the near future.

Since 2007, our target for investing in equity type investments (including property) has been 50% of the asset shares of the with-profits policies. We may change the mix of investments that make up the 50% equity type exposure from time to time so that we maximise fund performance.

5. Charges and expenses

Expenses include the costs of managing the fund, any tax liabilities, the costs of guarantees and smoothing (see section 8) and the costs of providing other benefits, such as life insurance.

Administration and investment management are provided by a service company and investment managers respectively. Service company fees and investment management fees are deducted from asset shares.

All administration expenses charged to asset shares are based on set rates agreed with the service company.

The investment management expenses charged to asset shares are based on the costs negotiated with our investment managers.

The costs of buying and selling the different types of investments in the fund are reflected in investment returns.



6. What the 'estate' is and how we use it

Within the Pearl with-profits fund there is what is known as an inherited 'estate'. The estate is a pot of money, or surplus over and above the amount needed to pay all the policies when they mature or surrender/transfer. The estate has been built up over many years and provides working capital for the fund. The Pearl with-profits fund is now a closed fund, which means that no new policyholders can invest in the fund. As time passes and the number of policies reduces, there is less need for this capital.

When the financial position of the fund permits us to do so we will distribute the estate in a manner which is fair to all policyholders. This will be achieved by paying higher amounts of final bonus (see section 8).

The amounts available for distribution may not be large, but we would expect such amounts to increase over time. However, the amounts that will be paid are not guaranteed and they will fluctuate depending on a number of factors including investment conditions.

7. Guarantees and regular bonuses

Your policy may guarantee to pay a certain amount at specific times in the future. Many with-profits policies have a basic sum assured. If you have such a policy, this basic guarantee will be set out in your policy document. Total guaranteed benefits include any annual or regular bonuses that have been added to the sum assured to date.

Typically we would pay guaranteed amounts;

- At a fixed maturity date for endowment life policies;
- Between a range of retirement dates or ages for pension policies;
- On the death of the life assured.



Why guarantees are important

In general, guarantees are set assuming a lower level of investment return than we expect to earn on the fund. This is to allow us some flexibility to invest in assets which can fluctuate in value in the short-term, but which are expected to offer a better long-term return. We aim to pay out values reflecting actual returns. However when investment returns are poor you are protected and will, as a minimum, receive any guaranteed benefits.

Regular (annual or daily) bonus

Over time, regular bonuses may be added, which increase the amount we guarantee to pay. For example, if you hold your endowment policy to maturity any regular bonuses that have been added to the basic sum assured are also guaranteed to be paid at the maturity date.

Pearl declares bonuses annually for conventional with-profits policies (see section 10). The rate of bonus can vary and it may be nil.

Bonuses are calculated and added daily for unithised with-profits policies (see section 10). The daily bonus will depend upon the premiums

paid and the daily bonuses previously added. The rate of daily bonus can vary and it may be nil.

Once an annual or daily bonus has been added, it increases the guaranteed amount payable on that policy and cannot be taken away.

Bonuses should not be thought of as being the same as the investment return on your policy. The actual return on the premiums you have paid will be reflected in your asset share, which may be higher or lower than the guaranteed benefits on your policy.

What we take into account in setting regular bonuses

When deciding whether to increase guaranteed amounts by adding regular bonuses we look at a number of factors:

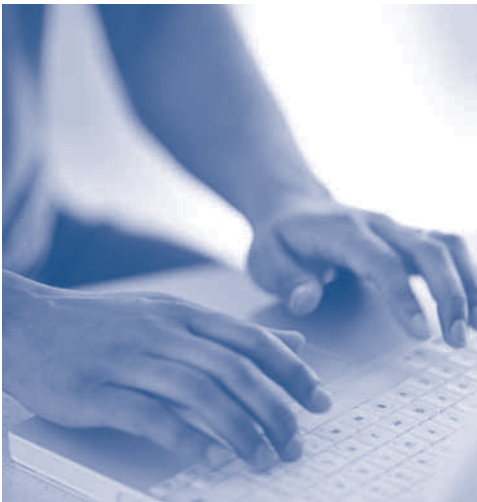
- The current financial position of the fund and how this is likely to change in the future.
- The level of guaranteed benefits compared to the asset shares. If the guaranteed benefits are higher than the asset shares then there might be no further regular bonuses added.

- The performance of the fund – both short term and long term. Even if the fund has performed well in a particular year we may not be able to add any bonuses.

We aim to be consistent when making bonus payments and will try not to vary the amount of regular bonuses too much from year to year.

8. Final bonus and how with-profits policies can cushion you from some of the ups and downs of the investment market (known as smoothing)

As noted in section 7, when setting guaranteed benefits we will typically assume a lower rate of return than we actually expect to earn on our investments. This allows us to invest a greater proportion of the fund in assets which may fluctuate more in the short-term, but which are expected to produce a better long-term return. To make up any shortfall between guaranteed benefits and the actual performance of the fund, final bonuses may be added to the guaranteed benefits described above when you make a claim on your policy.



Final bonuses are set with the aim that, on average, the total policy payout targets asset share (see section 3) plus any amount added to this from the distribution of the estate (see section 6). Final bonuses are not guaranteed and may be small or nothing depending on the performance of the with-profits fund.

Changes in the level of final bonuses may not directly correspond with changes in asset shares. The value of the investments in the with-profits fund can go up and down quite dramatically in the short-term but we aim to cushion with-profits policyholders from some of these ups and downs to some extent. We do not change the rates of final bonus very frequently (typically every six months for conventional with-profits), and, to a limited degree, we hold back some of the performance in the good years to use when returns are low.

When investment conditions decline for long periods, payouts to policyholders will correspondingly fall – we cannot fully protect policyholders from significant changes in investment returns over an extended period of time. However, as described above, the guaranteed benefits are the minimum we will pay and this guarantee can prove valuable in such circumstances.

9. How we decide how much you get if you end your policy early

If you end your policy early, either by surrendering it, or in the case of pension plans, transferring its value to another pension provider, we aim to pay your fair share of the fund – bearing in mind that we must be fair to policyholders who stay, as well as those leaving.

- For Conventional With-Profits policies we work out the surrender value with the aim of paying on average, around asset share.



Individual payments will vary within a range about this target. We may make various deductions to protect the interests of remaining policyholders.

- For Unitised With-Profits policies, we work out the surrender value by multiplying the number of units allocated to your policy by the current unit price (the 'unit value') and deducting any early surrender penalties (see explanation below). For a few policies issued in 1995, we may reduce the amount paid by applying a Market Value Adjuster (MVA).
- For all with-profits policies, the surrender value may include an amount in respect of the distribution of the inherited estate (see section 6).

What is a penalty?

Some Unitised With-Profits policies contain explicit penalties if you surrender your policy early. These products were designed to remain

in force for a number of years and the expenses incurred when the policies were sold were assumed to be spread over the life of the policy and offset against future investment returns. If the policy is surrendered in its early years, not all of those initial expenses will have been recovered and it is necessary to adjust the payout to properly reflect these expenses. The amounts that we may deduct for such early surrenders are detailed in your policy document.

What is a Market Value Adjuster (MVA)?
– also known as a Market Value Reduction (MVR)

An MVA may be applied to regular premium unitised with-profits policies issued in 1995 if the policy is transferred or surrendered early. The MVA is applied when the value of the units, after allowing for any penalties (see above), are greater than the value of the asset share.

An MVA is a way of reducing the amount paid out when asset share is below the value of the units.

The size of any MVA imposed will change from time to time, depending on, in the main, the performance of the with-profits fund.

The times when we could apply an MVA to your policy depends on the type of policy you have and are set out in your policy document. For example, we will not apply an MVA to a payment made on death.

10. What type of policy do you have?

Pearl has two main types of with-profits policy:

- Conventional With-Profits; and
- Unitised With-Profits.

Conventional With-Profits

If you have a Conventional With-Profits policy, there may be a basic guaranteed sum assured to which regular or annual bonuses may be added. These are usually announced annually. A final bonus may also be added when you make a claim on your policy – either at maturity, retirement, surrender, transfer, or earlier death.

Unitised With-Profits

If you have a Unitised With-Profits policy, units are allocated to your policy every time you pay a premium. Bonuses are normally added on a daily basis. A final bonus may also be added when you make a claim on your policy – either at maturity, retirement, surrender, transfer, or earlier death.

Your annual statement will help you to identify which type of policy you have.

11. How we manage exposure to risk

The with-profits fund is exposed to a number of risks as a result of product design, for example, providing guarantees to policyholders, past selling and marketing practices, interest rate and market fluctuations and population changes e.g. how long people are living.

Overall, we aim to minimise the risks to the fund and our business:

- By careful selection and regular review of investments.
- By containing or removing risks from the fund.
- By not accepting any new policyholders into the fund.

We also reduce the risks associated with the ups and downs of the investment markets by setting limits on the amounts we place in any one investment or with any one organisation.

12. Fairness between policyholders and shareholders

We have described how bonuses are decided in section 7. When you receive a bonus, the shareholder is also entitled to a distribution. However, at least 90% of the distributed profits go to policyholders.

13. How to find out more

You can get a more detailed technical description of how we manage our with-profits fund in our PPFM. You or your adviser can obtain a copy from our website (www.pearl.co.uk) or by writing to us.



None of the contents of this document forms part of, or varies, the terms or conditions of any policy issued or to be issued by Pearl Assurance Limited. In the event of any inconsistency between the contents of this document and any policy, the terms and conditions of the policy prevail. Life policies are legal contracts and cannot be altered without the agreement of the policyholder.

This document is not a comprehensive explanation of either the management of the with-profits business of Pearl Assurance Limited or of every matter, which may affect the business. In addition, no part of this document should be read as a recommendation to policyholders or potential policyholders or their advisers, in relation to maintaining a with-profits policy. Anyone considering whether to effect or maintain a with-profits policy with Pearl Assurance Limited, or any company within the same group, should seek independent financial advice.

Statements in this document in relation to the risks and rewards involved are, by their nature, forecasts subject to a variety of uncertainties. Readers of this document should read such forward-looking statements in that context.

Contact us

The Pearl Centre
Lynch Wood
Peterborough, PE2 6FY

TELEPHONE

0845 882 8121

FACSIMILE

01733 880 0850

E-MAIL

customersupport@pearl.co.uk

INTERNET

www.pearl.co.uk

If you would like this information
in large print, in Braille, or on
CD, please call 0845 301 0160.

Pearl Assurance Limited No. 1419, London Life Limited No. 1179800, NPI Limited No. 3725037 and National Provident Life Limited No. 3641947 are authorised and regulated by the Financial Services Authority. All companies are registered in England and have their registered office at: 1 Wythall Green Way, Wythall, Birmingham, B47 6WG, Tel: 01564 204321. We may record or monitor telephone calls.