Harcourt Life Ireland DAC

Principles and Practices of Financial Management

December 2018

The With-Profits Business of Harcourt Life Ireland DAC Principles and Practices of Financial Management.

Contents

Glossary

This Glossary is intended to be read as offering guidance on the general meaning of words and phrases, rather than as setting rigid legal definitions.

'actuary'	Means the *actuary* who has been appointed to the role of Harcourt Life 's Head of Actuarial Function in accordance with applicable regulatory rules and Harcourt Life 's governance structure.
'annual bonus'	A bonus declared following the principal annual investigation of the financial position of the With Profits Fund (WPF) and that applies to all policies in a specified class. It is added to the policies by way of an increase in the unit price, but becomes payable only when the policy as a whole becomes payable. Different rates of *annual bonus* may apply to different types of policy.
'asset share'	The amount of money that arises from: • the *premium* invested in a policy. • together with the *net investment returns* that are due. • less any expenses and charges not allowed for in the *net investment return.*
'final bonus'(also known as 'terminal bonus')	A bonus that is added when a policy becomes payable. Rates of *final bonus* are set from time to time but can be changed without notice. Different rates may apply to different types of policy and to policies of the same type issued at different times.
'governing body'	Has the meaning given in Section 1.10.
'guaranteed benefit'	Depending upon the type of product, this is a percentage of the *premium* paid, as specified in the policy document.
'Harcourt Life'	Harcourt Life Ireland Designated Activity Company.
'market value reduction' ('MVR' - also known as market value adjustment or MVA)	A deduction that may be made from the value of the with-profits *units* attached to a policy in certain circumstances when the policy is surrendered. See section 4.11 (1).

'net investment return'	The investment return earned by the WPF, for the particular currency sub-fund that the policy is denominated in, in any year after the deduction of any charges and expenses.
'payout'	The amount of benefit to be paid when a policy becomes a claim.
'PPFM'	This document, the Principles and Practices of Financial Management. We also produce a summary document – the Customer Friendly *PPFM*.
'premium'	The amount policyholders pay to the insurance company for their policy.
'shareholder'	Life Company Consolidation Group Limited ("LCCG"), in its capacity as the ultimate owner of Harcourt Life.
'smoothing'	An averaging process whereby Harcourt Life may adjust the payout on a with-profit unit that would arise from a mechanistic use of the *net investment return.*
'Smoothing account'	The difference between the *asset share* and the part of the policy proceeds on maturing/surrendering policies attributable to with-profits units (but excluding any difference attributable to a guarantee. The smoothing account may be positive or negative.
'surrender value'	The amount payable if a policyholder ends his policy at a time when the policy conditions do not provide for a guaranteed benefit to be payable.
'unit'	Policies have their benefits defined in terms of *units*. A unit represents a share in the assets in the WPF.
'WPF'	The with profits fund of Harcourt Life. The WPF forms part of the Life Assurance Business Fund "LABF" of Harcourt Life and is the sum of the value of the asset shares and the smoothing account.
'WPSF'	The WPF fund is split into three sub-funds depending on the currency in which the original policy was written namely euros, pounds sterling or US dollars

Introduction, Structure and Overriding Principles

1. Introduction

1.1 This document applies to certain business carried on within the With Profits Fund ('WPF') of Harcourt Life Ireland Designated Activity Company ('Harcourt Life'). It aims to define the Principles and Practices of Financial Management ('PPFM') according to which this business (the 'Business') is currently conducted.

1.2 With-profits business was first written and retained in the LABF of Harcourt Life in 2000. Prior to this, Harcourt Life wrote with-profits business ('Reassured Business') under which the policy benefits were reassured in the Overseas Life Assurance Business Fund of the With Profit Sub-Fund of its then sister company Scottish Mutual Assurance Ltd ('SMA'). In 2009, all of SMA's business was transferred to Phoenix Life Limited (PLL) and the reassurance is now to the Scottish Mutual With-Profits fund of PLL.

1.3 Harcourt Life has written with-profits business on a cross-border (international) basis and in Ireland.

1.4 This PPFM applies only to the with-profits business written internationally in Harcourt Life and sold to policyholders resident in the UK. It also covers the Irish funds only and the Reassured (OLAB) Business is subject to the PLL PPFM.

1.5 The PPFM may be revised by Harcourt Life from time to time and in any respect subject only to the constraints imposed by law and regulation. Harcourt Life will review the PPFM every year, although changes to it may be made more frequently.

1.6 This PPFM is the Harcourt Life WPF Version 14, dated **December 2018.**

Availability of the PPFM and reporting

1.7 The PPFM is available to policyholders and their advisers (amongst others) who are UK residents when they took out their policy and remain UK residents. It is designed to help them to understand the way in which Harcourt Life currently seeks to manage the Business.

1.8 Accordingly, any such policyholder with a Harcourt Life with-profits policy will be supplied with a copy of the relevant PPFM at any time on request and without charge. Other persons may, at the discretion of Harcourt Life, be supplied with a copy of this document on request and on payment of a fee.

1.9 Harcourt Life will maintain a record of each version of the PPFM for at least six years from the date on which that version is superseded.

Approval of the PPFM and Governance

1.10 The PPFM is approved by the Harcourt Life Board.

1.11 Harcourt Life is an Irish life assurance company ultimately owned by LCCG and is regulated by the Central Bank of Ireland. The immediate 100% shareholder is Utmost Pan Europe Designated Activity Company, which is also regulated by the Central Bank of Ireland.

PPFM relationship

1.12 Readers should be aware that the PPFM is not intended to alter the rights and obligations policyholders and Harcourt Life have under any policy documents that Harcourt Life has issued. Should there be any conflict between what is said in the PPFM and what is said in any such policy document, the latter shall prevail. For these purposes, 'policy documents' means the documentation containing the terms of the contract between Harcourt Life and the policyholder. This may include information or documents supplied to Harcourt Life by the policyholder, or on his behalf.

1.13 It is important to understand that the Principles and Practices set out in this document describe the way in which Harcourt Life currently seeks to manage the Business.

1.14 Management of the Business is not a mechanistic process carried out strictly on the basis of compliance with a detailed set of pre-determined criteria. Rather, it requires Harcourt Life to make many judgements about the actions it should take in endeavouring to meet the objectives which are described in the Principles and Practices set out in the PPFM.

1.15 Those judgements are made by Harcourt Life in good faith, with a view to achieving what Harcourt Life believes to be a fair balance between the different interests of individual policyholders and groups of policyholders, and furthering the interests of policyholders as a whole. They are based, amongst other things, upon assumptions about the future, the fulfilment of which clearly cannot be guaranteed by Harcourt Life. Equally, Harcourt Life cannot guarantee that the judgements it makes will result in the objectives described in the Principles and Practices set out in this document being achieved.

1.16 With-profits contracts of insurance are long-term in nature. While Harcourt Life wishes its policyholders to have as clear an understanding as practicable of the material bases on which Harcourt Life seeks to manage the Business, it is not in policyholders' interests for Harcourt Life to do so by reference to inflexible criteria. Harcourt Life therefore seeks to respond to events in managing the Business, and to evolve the Principles and Practices by reference to them. These Principles and Practices have evolved significantly over time, in response to changing experience within the Business, and changing events outside it. This evolutionary process is likely to continue into the future.

Currency

1.17 Harcourt Life offered its customers certain choices for the currency of their investment and the Business includes liabilities to policyholders in each of Sterling, US Dollars and Euros. The amount of liability in each of the currencies is separately recorded and the net investment return differs for each of the currencies.

New Business

1.18 Other than as described in section 9 (Volumes of new business) below, the WPF is not currently open to new business.

Closure of the With-Profits Sub-Fund

1.19 The WPSF may be closed if the Technical Provisions of the HLI WPSF falls below €50 million. If the Board of HLI determines that the fund is to be closed, such policies will no longer participate in profits. In the event of closure, any profits shall be distributed in accordance with advice obtained from the actuary. Closure of a WPSF requires the Board to receive a certificate from an Independent Actuary to the effect that in the opinion of the Independent Actuary, the WPSF closure will not have a material adverse effect on the security and benefits of the holders of policies allocated to that WPSF.

2. Structure of the PPFM

The Principles

2.1 The Principles describe Harcourt Life's aims and objectives in the management of the Business and are designed to be long-term in nature, although this does not mean they will not change, particularly if there is a need for change due to new or difficult circumstances. The PPFM contains two different types of Principle: **'Overriding Principles'** and **'Operating Principles'.**

2.2 The Overriding Principles are intended as enduring and overarching standards adopted by Harcourt Life. There are then more detailed Operating Principles and Practices covering specific topics.

2.3 In the event of any conflict between them, the Overriding Principles take precedence over the Operating Principles and Practices, and the Operating Principles take precedence over the Practices. Within the Overriding Principles, the first and second Overriding Principles take precedence over the others.

2.4 Principles are shown in **bold text** in this document.

The Practices

2.5 The Practices aim to set out the way in which Harcourt Life seeks to manage the Business in more detail. Taken with the Principles, they aim to provide sufficient detail to enable a knowledgeable observer to understand the material risks and rewards for a policyholder investing in the WPF.

The Business

2.6 All the Business is of the same type, in that it is unitised with-profits business. Whilst there is a small amount of regular premium with-profits business, none of this business was sold to UK residents. The vast majority of the Business is of the with-profits bond type, a policy whereby a single investment is made at the outset with no further premium required to be paid by the investor under the terms of the contract.

3. Overriding Principles

3.1 **The Overriding Principles are as follows:**

(1) The WPF will be managed on a sound and prudent basis with the objective of securing that its assets are at all times sufficient to meet its liabilities and related reserving and capital requirements without the need for capital additional to its existing resources and such other assets as the shareholder may from time to time agree may be utilised.

(2) Harcourt Life seeks to operate within the legal framework governing Harcourt Life's long-term insurance business. This framework includes:

(i) Harcourt Life's Constitution;
(ii) the contractual commitments made to all Harcourt Life's long-term policyholders including guarantees; and
(iii) the requirements, from time to time, of the regulators of Harcourt Life's long-term business.

(3) Harcourt Life aims to balance the interests of different groups of policyholders fairly in relation to each other and fairly in relation to the interests of the shareholder.

(4) Bonus rates may be smoothed so that some of the fluctuations in the value of the investments of the WPF are not reflected in payments on with-profits policies.

(5) Returns on with-profits policies may be reduced by adverse experience within the WPF. Only in extreme circumstances could returns on policies be reduced by adverse experience on other insurance business in the long-term fund of Harcourt Life.

(6) Harcourt Life will endeavour to give policyholders in the WPF participation in the asset classes they have been led to expect by statements made by Harcourt Life and the overall risk profile in the fund that they have been led to expect by statements made by Harcourt Life (in each case in the context, for example, of policy documents and related literature, changes in industry investment policies and outlook, and the financial condition of the WPF).

3.2 The first Overriding Principle may impose restrictions on the ability to declare bonuses or may require adjustment to the liabilities, perhaps by reductions to the net investment returns credited to the asset shares in accordance with section 4.

4. The amount payable under a with-profits policy

Introduction

For most policies the life-cycle is that the policyholder pays a *premium*. We use some of the *premium* to pay our expenses and costs and the rest becomes part of the WPF and shares in the *net investment returns.* The policy may receive *annual bonuses* and when the time comes for the policyholder to claim the benefit of the policy we may add a *final bonus* or charge an MVR.

The WPF is primarily an investment fund, but is required also to meet certain guaranteed liabilities. There is some averaging, or smoothing, of achieved investment results.

Harcourt Life may add annual bonuses from time to time and may also add a final bonus at the end of the policy. Specific benefits are detailed in the policy terms and conditions.

This section 4 discusses in turn the four topics of *asset share, annual or regular bonuses, final bonuses and smoothing*.

Guideline payout amounts

4.1 Sections 4.2 to 4.5 cover the methods used by Harcourt Life to guide its judgement of the amounts that it believes it is appropriate to pay individual with-profits policyholders.

4.2 The normal form of a with-profits policy has historically been that it is subject to either a single premium paid at the start or to premiums payable in regular (and usually equal) instalments paid annually (or more frequently) and a single payment of benefit when the policy ends.

The method used by Harcourt Life to guide its judgement of the amounts it believes it is appropriate to pay individual policyholders is to calculate 'asset shares'.

More detail of the calculation of asset shares is given in section 4.4. The methodology is similar for single premium and regular premium policies, but only the single premium methodology is relevant here and so is described.

Naturally, the size of an individual policyholder's asset share changes over time. It may increase or decrease from time to time, according to (amongst other things) investment performance and other experience within the WPF (for example, asset shares may be adjusted in order to accommodate exceptional developments within the WPF).

4.3 (1) For all contracts the aim is to pay a fair share of the available assets (subject to any guaranteed benefits), with the payouts to policyholders targeted as far as possible on a percentage of asset shares. In general, the target percentage is 100% of asset shares but in certain circumstances the target percentage may differ from 100% as referred to in section 6.4 and section 8. In addition, in certain circumstances the amount paid may differ from 100% of asset shares. For example, guarantees within the policy conditions may necessitate a payment in excess of 100%. Moreover, for exits at short durations, the percentage may be less than 100% of asset shares if to pay 100% would require a final bonus. More details of the current calculation methods are given in section 4.4.

4.3 (2) **Harcourt Life aims to calculate the guideline payout amounts to within an accuracy of a few percentage points. However the application of other principles and practices, particularly the degree of smoothing applied (see section 4.12), may result at times in a wider gap between the guideline amounts and the actual payouts. Guarantees of minimum amounts may also apply to exits on certain dates.**

4.3 (3) **Material changes to methods would be made only following a decision of the Harcourt Life Board, based on a recommendation by the Actuary.**

4.3 (4) **Harcourt Life seeks to base its decisions on what it believes to be the best and latest reasonably available information. In the calculations of the guideline payout *amounts* the assumptions and parameters for the current and immediately previous year are subject to revision at any time as more detail becomes available on emerging trends. Such assumptions and parameters will be set by the Actuary and reported to the Harcourt Life Board.**

Changes to assumptions and parameters for earlier years would be unusual (but are possible, and are from time-to-time contemplated) and made only after the Actuary had submitted a report to the Harcourt Life Board giving his explanation and justification for the changes.

Examples of previously applied assumptions and parameters that might be changed in this way are net investment returns or charges.

4.4 (1) This section describes the method we seek to use to calculate the asset shares. There may be charges dealt with outside the WPF and policyholders are advised that for a full understanding of their contracts they may need to read their policy literature as well as this PPFM. It is only that part of the premium which is allocated to investment that is included in the asset share calculation. There is a further discussion of charges in section 7.

A model is maintained which rolls up an accumulation of a sample premium (after deduction of product specific charges if appropriate), at the achieved investment return after charges for each currency sub-fund of the WPF. Various versions of the model are maintained which allow for the different annual management charges that apply to different series of units. The net investment return may also be adjusted to allow for other costs that are reasonably chargeable to the Business; for example to reflect the cost of guarantees or to credit/debit any miscellaneous profits/losses attributable to the WPF. Such charges may be different for different classes of policy or series of units.

The resulting accumulation from the start date of the policy concerned to the current date is taken as the guideline asset share. The guideline asset share is compared against any guaranteed minimum payments promised to the policyholder at particular dates. If the guarantee gives an amount greater than the guideline asset share at a date when the guarantee is applicable, then the guaranteed amount is paid.

4.4 (2) The only principal assumption is the tax rate to apply to the investment return, which is currently zero as policyholder funds accrue tax free in Harcourt Life.

4.4 (3) The experience within the WPF borne by the Business is generally limited to the investment and financial experience of the WPF with different investment experience for the different currency sub-funds. Much of the non-investment and non-financial elements, such as expenses, are dealt with outside of the WPF (see section 6). Investment returns achieved are calculated on a monthly basis by reference to the actual performance of the assets in the relevant sub-fund. Guarantee and other costs may be charged against the net investment return where Harcourt Life judges it to be appropriate. *Asset shares* are maintained on a calendar month of commencement basis and updated monthly.

4.4 (4) The overall methods for determining guideline payout amounts are as documented in the PPFM as updated from time-to-time. What we believe to be sufficient further details of the underlying asset share models to enable them to be operated appropriately are included in the procedure notes for the models used. Successive changes to the parameters and assumptions will be documented in reports submitted to the Harcourt Life Board.

The interpretation of the results and the development of proposed bonus scales (both annual and final bonuses) are documented in the reports submitted by the Actuary to the meetings of the Harcourt Life Board at which decisions on new scales of bonus to be declared are taken.

4.4 (5) The methods, parameters and assumptions described in this section 4.4 are subject to controls exercised by the Actuary and the Harcourt Life Board.

Values for parameters for the current or previous year that are assessed under agreed methods will be subject to sign-off only by the Actuary. Changes to parameters for earlier periods will be made by the Actuary, but only after the submission to the Harcourt Life Board of a written report explaining and justifying the changes.

Material changes to methodology will be subject to sign-off by the Harcourt Life Board, on the recommendation of the Actuary.

4.4 (6) The Harcourt Life Board may set aside reserves within the WPF to cover matters relevant to policyholders' interests and security and may take appropriate actions, in relation to the policies and practices of the WPF (for example in relation to asset mix or investment policy) or the level of benefits paid to policyholders in respect of those interests and security

4.5 The sections above contain general descriptions of how Harcourt Life brings investment returns, expenses, charges and tax into account by determining the guideline amounts for payments to policyholders. Further details of the determination of actual amounts to be paid are included under final bonuses (sections 4.9 to 4.11 below). Some further specific details are noted in the subsections below.

4.5 (1) Harcourt Life does not currently make any distinctions between different classes of policy in recognising the gross investment return to use in its calculation of asset share models other than by reference to the currency sub-funds. In particular there are units denominated in three different currencies (£, $ and €) with premiums in each currency being applied to three distinct currency sub-funds. Each currency sub- fund is separately maintained and has its own notionally allocated assets, with the performance of those notionally allocated assets driving the calculation of the specific investment return of each sub-fund. The actual calculations use gross of tax investment returns as no policyholder tax is currently applicable.

However, Harcourt Life reserves the right to make further distinctions in future between different parts of the WPF or between different classes of policy in recognising the gross investment return if deemed fair and appropriate

4.5 (2) Costs directly related to the investment activity such as stamp duty and stock-brokers' fees are charged against the investment return. Other expenses charged against the unitised policies are not based on actual costs, but rather on set levels of charges (as disclosed in the point-of-sale literature).

4.5 (3) The bonus allocated to unitised policies using units in series 1, 3 and 4 does not give rise to any transfer to the shareholder. For series 2 and 5 units 85% of the total amount available for distribution is used for bonuses and 15% of the amount available for distribution goes to the shareholder by way of an annual distribution charged to asset shares.

4.5 (4) In relation to the with-profits business, guarantees, other risks and the cost of the provision of capital will normally be charged for within the LABF and are not normally charged to asset shares.

Annual Bonuses

4.6 Distributions of surplus take the form of 'bonuses' and there may be both annual bonuses and final bonuses. These are discussed separately.

Sections 4.7 and 4.8 describe Harcourt Life's approach to setting annual bonus rates for policies in WPF. Annual bonuses normally become guaranteed additions to the policy benefits, so long as the benefits are not surrendered when Market Value Reductions may be applicable.

4.7 (1) Harcourt Life's general aim in fixing rates of annual bonus is to set the annual bonus rate at a level which is reasonably expected to be sustainable over the medium term, having regard to the prevailing expected future investment returns (allowing for the asset mix of the WPF) and deducting an appropriate amount for charges and an amount held back with the intention of facilitating the build up of final bonus.

The Overriding Principles lead to a general constraint on Harcourt Life in that it will declare annual bonuses only if it believes it can do so without undue risk to its solvency or to the security of policyholders' guaranteed benefits.

4.7 (2) Harcourt Life has several different series of with profits units. Annual bonus rates may vary between series. Examples of the factors that have caused different series to be thought necessary or desirable have been:

(i) The relevant policies were to have different annual management charges.

(ii) The underlying levels of guarantees were to be different.

(iii) The units were to be denominated in a different currency.

Harcourt Life utilises a notional allocation of assets to the various currency sub-funds of the WPF, such that those units denominated in a particular currency will have an investment experience weighted towards the experience of assets also denominated in that currency.

4.7 (3) The WPF is not currently open to new policyholders, but these factors would be relevant to any decision on a new bonus class were the fund to be re-opened (as would the general economic conditions at the time).

4.8 (1) The annual bonus is the rate at which the unit price grows. It is declared in advance as an annual rate, although the unit prices are increased daily to reflect the declared rate.

The starting point in setting annual bonuses will normally be the current expectation of the average long-term net investment return on the fund. From this will typically be deducted, for example;

(i) Any annual management charge. The annual management charge is part of the overall policy charges and varies between series of units.

(ii) An allowance intended to facilitate the build-up of final bonus if actual returns outstrip the annual bonus rates or to rebuild the final bonus element of the overall return following a period when annual bonus rates have been higher than actual returns. The allowance may vary with the investment strategy of the WPF.

(iii) Any tax due (although this is currently zero).

It should be noted that whilst the annual bonus rate can be zero, it cannot be less than zero. The annual bonus rate is declared net of annual management charges.

In practice, actual returns achieved will inevitably differ from expectations. Recent investment experience is also a factor in setting the annual bonus rate in that, after a period of favourable experience, Harcourt Life would be more tolerant of annual bonus rates in excess of the target and conversely after a period of adverse experience, would aim for lower rates. In, or following, seriously adverse conditions annual bonuses might be restricted further if, for example, that were deemed necessary to safeguard solvency.

4.8 (2) The annual bonus rates are declared in advance around April each year and apply from the 1 May each year.

4.8 (3) Subject always to the possible restriction described in 4.8(1) above, the maximum change in annual bonus rates is 2% (based on the equivalent compound rate) in any one year.

4.8 (4) The concept of interim bonus does not apply to this business.

Final Bonuses

4.9 Sections 4.10 and 4.11 cover Harcourt Life's approach to setting final (or 'terminal') bonus rates. Final bonuses are adjustments made to the claim value of a with profits policy which is terminating in whole or in part.

Final bonuses may be declared on any policies. More details are given in 4.10 and 4.11.

4.10 Harcourt Life*'s* overall aim is to set final bonuses, such that, in conjunction with annual bonuses added over the lifetime of the policies, amounts close to the full amount of the net investment returns achieved are, as far as possible, paid to policyholders (subject to the possible modifications indicated in 4.3(1)). In addition, the comments in the *Smoothing* section below and that relating to *Business Risks* are also relevant.

The term 'final bonus' can be interpreted in two ways. The 'final bonus' can be negative or positive (or zero). A positive adjustment is normally called a final (or terminal) bonus and a negative adjustment is normally called a Market Value Reduction (MVR) factor. With some exceptions, described in 4.11 below, the same broad methods and principles apply in both circumstances. However, note that some policies have a date, which is outlined in their terms and conditions, when a minimum encashment value applies.

4.11 (1) A model is maintained which calculates a roll-up of premiums as described in 4.4(1). Two sets of calculations are carried out. One is a roll-up at the declared annual bonus rates that have applied over the years and the other is a roll-up at the achieved net investment returns for the currency sub-fund in question. The investment returns used are net of charges (including, where Harcourt Life judges it appropriate, any charges for providing guarantees). The investment return achieved in any one calendar month is deemed to have accrued evenly over the month, which implies a degree of smoothing of investment returns. Where policy conditions allow, MVRs may also be applied when there has been, or is expected to be, a high volume of surrenders in relation to the liquidity of the WPF.

Calculations are performed separately for different series of units and separate final bonus and MVR scales are declared for the different series, and different currency denominations.

The primary output from the model is the ratio that the roll-up of premium at the achieved net investment return bears to the roll-up at the credited annual bonus rates. Where this ratio is greater than 1 there is theoretical potential for a final bonus and where the ratio is less than 1 there is theoretical justification for any payout being less than the nominal value of the units by means of the application of an MVR. The overall aim, as stated in 4.10 and 4.3(1)) is to pay out to policyholders as a class over time, by means of the combination of annual and final bonuses, something close to the full amount of the net investment returns achieved (after the deductions referred to above). However, the comments under *Smoothing* below are relevant. The neutral value of 1 for the ratio may be departed from when the 100% factor discussed in 4.3(1) and section 8 is departed from.

When a new scale of final bonus or of MVRs is set the aims are:

(a) To set the scale at levels such that no individual policyholder who has held his policy for a reasonable period, say 5 years, receives benefits which are more than a few percentage points away from the theoretical result.

(b) In general, whilst it would be unusual to credit final bonuses for exits at very short duration, MVRs would nevertheless be applied at very short durations if justified by the calculation described above.

(c) To limit the size of change in final bonuses or MVRs at any one review. Changes in final bonuses or MVRs which generate a movement in total payout on a policy in excess of 10% should be exceptional. There is, however, no limit on the frequency of reviews of final bonus or of MVRs.

(d) Small MVR percentages may, at the discretion of Harcourt Life, not be imposed particularly if volumes of potential or actual surrenders are insignificantly small. Conversely larger MVRs might, where policy conditions allow, be applied where there has been, or is expected to be, a high volume of surrenders relative to the liquidity of the WPF.

At the date of this PPFM, MVRs are being applied to some policies exiting from the WPF, which were issued immediately after the high-point in the equity market at the start of 2000.

Moreover, the MVR scale aims to ensure that policies remaining invested in the WPF are not adversely affected as a result of exits receiving more than their fair share of assets. Harcourt Life would expect, if MVRs are justified, to apply them in most such circumstances, subject to smoothing considerations (as described in sections 4.12 - 4.14).

4.11 (2) Scales of final bonus are set by the Harcourt Life Board, but the Harcourt Life Board has delegated authority to the Appointed Actuary to revise MVR scales as necessary. Whenever a new final bonus scale is set, a new MVR scale would normally accompany it, with there being no policies subject to both final bonus and MVR at the same time. However, if conditions were to subsequently deteriorate such that management decides to introduce a new MVR scale, without there being a new final bonus scale, it is possible that there will be policies to which both an MVR and a final bonus would apply. In such circumstances, the calculation systems will apply both rates and produce a net result.

4.11 (3) Some policy classes may also have early surrender charges as part of the charging structure disclosed at point-of-sale. Any MVR is in addition to such charges.

4.11 (4) Harcourt Life currently reviews the scales of final bonus at least twice a year, although it reserves the right to review them more frequently should there be a material alteration in the economic conditions. The MVR scales are checked more frequently, typically once a month, although monthly reviews do not necessarily lead to monthly changes in the scale.

Smoothing

4.12 Sections 4.13 and 4.14 cover Harcourt Life's approach to smoothing. Smoothing refers to a process by which movements in underlying asset values are not always immediately or precisely reflected in payout values. As a result, the amounts paid or allocated as bonus in practice may not be exactly equal to the guideline payout amounts described earlier. Section 4.15 notes the target ranges which indicate the limits of smoothing.

4.13 (1) Harcourt Life does not intend to differentiate in its smoothing policy between policies of different types, or between different types of claim. Smoothing is a function carried out over the whole fund, rather than over sections of it. There is not, for example, any specific mechanism aimed at making smoothing neutral within each currency section.

4.13 (2) Harcourt Life intends smoothing to be neutral over the lifetime of the fund, which is likely to be a period of many years. Harcourt Life has not adopted any specific shorter time period over which it will aim for smoothing to be neutral. Indeed it may be necessary to retain some capital until the later years of the expected lifetime of the fund to cover the risk of unforeseen adverse experience.

4.13 (3) Harcourt Life believes that the total costs or scale of smoothing over the shorter term should be kept small relative to the size of the WPF.

4.13 (4) Other than in exceptional circumstances, Harcourt Life expects to apply MVRs based primarily on a comparison of the net investment return with the annual bonus additions. The percentage adjustment referred to in 4.3(1) may apply. A secondary influence will be the rate of surrenders (actual or projected) in the fund.

4.14 (1) In assessing the extent of smoothing at any time, Harcourt Life is not constrained by any fixed rules but is likely to be influenced by the degree of over or under payment relative to asset shares in current payouts and the aggregate result of previous smoothing. As the overall resources of the fund are limited, any over payment to one group of policyholders has the result that there is less available for other groups of policyholders. If Harcourt Life believes the current payouts are potentially a material drag on the likely future payouts to policyholders remaining in the fund or represent a possible threat to the solvency of the fund, it is likely to adjust the value of current payouts to appropriate levels more rapidly, with considerably less regard to smoothing considerations.

4.14 (2) For the purpose of 4.13(3) 'small' is currently taken to be less than 5% of the WPF.

4.14 (3) Harcourt Life will maintain a smoothing account in order to track total cost or scale of smoothing.

4.14 (4) The strategy for smoothing is an objective to keep the actual payout levels close to the desired percentage of the guideline payout amounts by making changes to the bonus or MVR scales that will result in immediate changes to the amount of payout of all or most of the difference between current actual payouts and guideline amounts. This objective may not always be achieved, particularly if market movements are significant.

4.14 (5) The current approach to changes in value at any one review of bonuses has been indicated in 4.14(3). Harcourt Life has not adopted any limit to apply to changes in payments between one period and another.

4.14 (6) Harcourt Life's approach to surrender values is based on setting final bonus and MVR scales that normally approximate to within 5% of the guideline payout amounts at the time the scale is set. Harcourt Life would normally expect to review the MVR scale when it became aware of a shift in the theoretical scale of 5% or more, although at times of very rapid fluctuations in asset values, this 5% limit might be exceeded.

4.14 (7) Where a partial payment is made under a policy in circumstances where the policy provisions provide that no penalty can apply (most commonly where 'income' is being taken from a with-profits bond) and there is, in consequence, an overpayment relative to the appropriate guideline payout amount, any cost is charged against the fund and not against the individual policy concerned. Policies taking advantage of such guarantees do not therefore have their own costs taken into account when the policy finally becomes a claim for the full remaining benefit, other than in respect of the way in which such costs have a general impact on the fund.

4.15 (1) Harcourt Life has adopted a target range and aims to manage the business so that at least 90% of the payouts will fall within the target ranges. The range is expressed as a proportion of the unsmoothed asset share.

4.15 (2) For all forms of policy exit the target range is 80% to 120% of unsmoothed asset share.

5. Investment Strategy

This section of the PPFM aims to cover the significant aspects of the investment strategy of WPF.

5.1 **The WPF currently aims to achieve its investment objectives with investment in a relatively broad range of asset types which may include equities, bonds, cash and alternative investments, with the percentages of the fund in the various asset types being capable of variation within a relatively wide range at the discretion of the Harcourt Life Board, having regard to, inter alia, advice from the investment managers of the WPF. Indeed, at certain times, there may be no investment in certain asset types.**

- ‘Equities’ includes exposure to ordinary shares issued by UK and overseas companies.
- ‘Bonds’ includes fixed-interest investments issued by the UK and overseas governments and non-governmental bonds (for example, those issued by companies).
- ‘Cash’ includes bank deposits and short-dated commercial paper.
- ‘Alternative investments’ includes hedge funds.

The investments may be direct or via collective investment schemes such as unit trusts.

5.2 (1) **The primary aim of the strategy is to achieve security for the guaranteed benefits attaching to with-profits policies in the WPF, through choice of asset mix, a widely diversified approach to risk, having regard to the expected cash flow from the investments relative to the projected cash flow required to meet required payments to policyholders. A secondary, aim is to optimise the expected return achieved on the assets within the WPF, consistent with acceptable risk, over the expected period of investment.**

In addition, there is currency matching in that the liabilities in the different currencies are covered by investments denominated predominantly (although not entirely) in the currency of the liabilities.

5.2 (2) The WPF currently relies upon assets outside the WPF to maintain its solvency. These assets are surplus assets within the Non Profit Fund of Harcourt Life, which serve to maintain the solvency of Harcourt Life as a whole.

5.2 (3) Where a mis-match between assets and liabilities (particularly any guaranteed liabilities) represents a risk to Harcourt Life's overall solvency, derivative assets to hedge some or all of those risks may be purchased and held either inside or outside the WPF. This mismatching applies particularly to equity risk but may also apply to interest rate or currency risk.

Derivatives may also be used to implement policy decisions (for example movements between asset types) where this would represent efficient portfolio management.

5.2 (4) Harcourt Life has not imposed any constraints upon the investment strategy to apply to particular parts of the WPF other than the differentiation by currency of assets between the notional currency sub-funds as referred to in 4.7(2) and 5.3(4) below. Otherwise, the investment strategy and risk profile of the WPF is assessed at a total fund level rather than at sub-fund level, although there may be future circumstances when such consideration is desirable at sub- fund level (for example if assets to hedge the guarantees were to be held within the WPF).

5.2 (5) *Harcourt Life* aims always to maintain assets within the counterparty limits set by financial regulators and may impose stricter internal limits, where *Harcourt Life* judges it to be prudent.

5.3 (1) If it were proposed that the WPF should receive support from outside the WPF, then any transfer of assets to the WPF would only be made after the Harcourt Life Board had received a report from the Actuary that he was satisfied that the financial support being provided to the WPF was in the interests of the WPF policyholders. For any such support due consideration would be given to the 'retrievability' of the support and the accounting for it, in the light of the detailed conditions of the support.

5.3 (2) The WPF investment performance is currently monitored quarterly by the Actuary and the asset liability management function of the Company. Commentaries on performance and recommendations for change to strategy are proposed and formal discussions take place regularly at meetings of the Harcourt Life Board.

5.3 (3) At times when the level of solvency cover in the WPF, considered as a whole, is high, the investment managers are given greater freedom to invest in real assets and if a positive view is held of the potential future returns available from real assets such as equities, (relative to those available from bond or cash investments) exposure to such assets could be higher. At times when the solvency cover in the WPF is weaker, then the degree of freedom allowed will be reduced and Harcourt Life would move progressively towards closer matching of liabilities by assets whose return is more certain. In these circumstances, the exposure to real assets will be considerably lower, with correspondingly higher exposure to bond and cash assets.

A further important factor for the WPF is the likely timing of withdrawal of policyholder monies, particularly given the guarantee dates (dates when a minimum payment on exit is guaranteed). The investment strategy will have regard to the need for substantial liquidity to fund potential exits.

5.3 (4) Counterparty limits are set based upon Harcourt Life’s assessment of counterparty credit ratings and in accordance with specified concentration limits. The relevant exposures are calculated based upon the value of all investments excluding assets and liabilities of dependents, but including all debts. Derivatives, the value of units in collective investment schemes and trade investments are specifically excluded from this calculation.

Investment guidelines and asset allocations are kept under review, and both may vary in the light of changing financial conditions, industry developments and the Overriding Principles.

The asset allocations being targeted in respect of the WPF as at the date of publication of this PPFM were:-

	Percentage of Total Fund Value
Equities	50.0%
Fixed Interest	37.5%
Cash	12.5%

Actual asset allocations at any time may vary by a few (typically less than 5) percentage points from the guideline asset allocation percentages at that time.

As at the date of the PPFM the Harcourt Life Board has not utilised property investments at all.

As explained in 5.2(3), Harcourt Life has entered into hedging arrangements which are intended substantially to reduce the WPF's market-risk exposure to certain guarantee costs. Since the return from those arrangements is expected to be used to help meet guarantee costs (rather than be applied to unsmoothed asset shares), the table above does not take into account assets which are invested in those hedging arrangements.

5.3 (5) The use of new investment instruments would require prior approval in principle from the Harcourt Life Board. Harcourt Life's Board has delegated the responsibility for the detailed consideration of the use of new asset and liability instruments to the Company's senior management. The committee's approval is required to mandate new product purchases and new hedging instruments.

5.4 There are no material holdings of assets that would not normally be traded because of their importance to Harcourt Life, nor does Harcourt Life currently expect there to be in the future.

6. Business Risk

6.1 This section of the PPFM covers the exposure of Harcourt Life's with-profits policies to business risks.

6.2 Although investment risk is normally the major determinant of with-profits policy benefits there can be exposure to other types of risk. With-profits funds are typically often exposed to risks arising from:

(i) with-profits policies;

(ii) non profit policies; and

(iii) more general business risks arising from investment in connected companies.

As noted in the Glossary, the WPF is not a separate legally identifiable fund but forms part of the long term fund of Harcourt Life. Business risks therefore relate to the total LABF. However, these risks only prevail in very extreme scenarios and in the ordinary course the UWP policies are not exposed to any business risks.

6.3 The WPF will not normally undertake any business risks other than those resulting from maintaining and acquiring with-profits policies. The WPF is not currently accepting new policyholders, so such business risks will in future be restricted largely to those arising from maintaining (and having acquired) with-profits policies and associated activities.

Other investments, such as investments in connected companies (*eg* investment management companies, service companies or overseas subsidiary insurance companies) would normally be effected either directly by the shareholder or from funds outside the WPF.

Any proposal for any such investment would be considered by the Harcourt Life Board and the Actuary.

In the unusual event of the WPF agreeing to any such investment, then all profits and losses from such investment would be earmarked for the WPF.

The management of, and the risks and rewards from, non-profit policies takes place outside the WPF and could only affect the WPF in the extreme event of the insolvency of the whole of Harcourt Life.

6.4 The WPF operates a system of notional ring-fencing of assets, between the various currency sub-funds of the WPF. This ring-fencing, which has existed from the inception of the WPF, is notional, but does not extend to ring-fencing of liabilities and is not watertight in the event of insolvency of the fund or of Harcourt Life. Therefore, the three sub- funds (and Harcourt Life generally) depend on each other for their solvency.

There is the potential that the guarantees on the main bond classes (that the payout on a pre-determined anniversary of commencement will not be less than a pre-determined multiple of the original investment (adjusted for subsequent withdrawals)) will generate costs. In addition, certain classes of policies have the right to take annual withdrawals up to a specified limit without the imposition of any MVRs to those payments.

Smoothing costs (or benefits) arising from WPF policies are charged against (or credited to) the *smoothing account*.

In the event that the LABF is or would be in default if the charges were made to it, the considerations in the first paragraph of 4.3 (1) apply, in that Harcourt Life reserves the right to target less than 100% of the asset share, or guarantee costs may be charged against the net investment return used for asset share calculations.

However, before any such charges for guarantees are introduced, Harcourt Life would communicate this fact to policyholders, the proposal having first been approved by the Harcourt Life Board.

6.5 Harcourt Life has not established a formal monetary limit to the taking on of business risk by the WPF, but the general statements in 6.3 apply and any such risk is expected to be small in relation to the overall size of the fund. Any costs arising from business risks taken on by the WPF will be borne by that fund (disregarding the existence of the currency sub-funds). Costs arising from business risks not taken on by the WPF will be borne by the fund which took them on and which expects to profit from them if the experience is favourable.

6.6 (1) Harcourt Life has no formal monetary limits for the taking on of business risk in the WPF, but the general statement above that this would be done only in rare circumstances applies.

6.6 (2) Where any profits or losses did arise from risks taken in WPF, these would belong to the WPF and would either be allowed for as a specific adjustment to the investment return for the year, or would affect the *smoothing account* and hence the guideline payout amount. (See also the following paragraph and section 8).

6.6 (3) The WPF participates only in the investment and financial experience, but this may include the cost of guarantees on the business, where Harcourt Life judges this to be appropriate. Charges and expenses are discussed more fully in Section 7.

7. Charges and Expenses

7.1 This section of the PPFM covers the way in which Harcourt Life applies charges to policies and apportions expenses in respect of the costs of administering the WPF. Most of the costs are initially incurred within a service company and charged to Harcourt Life based upon a defined scale of product charges. Harcourt Life takes charges from the Business, which it can then utilise to the extent possible to meet these costs.

7.2 (1) In respect of Harcourt Life's business there were stated levels of charges disclosed in the product and marketing literature (although there are provisions that would allow Harcourt Life, in certain circumstances to alter the levels of some of these charges). Harcourt Life intends to levy charges at these levels, for as long as such levels are deemed to be fair and reasonable, subject to 7.2(2) and 7.2(3) below. Hence, subject to the above, the charges applied to policies are as set out in the literature and are not directly related to actual ongoing expenses incurred.

7.2 (2) The charges on the contracts arise from:-

- **An annual (distribution) charge levied on the WPF, expressed as a percentage of either the increase in the nominal value of the units or the nominal value of the units.**

- **A variety of establishment and other charges (eg. policy fees, Bid/Offer spreads) either deducted from the specified payment to or from the policyholder or taken by cancelling units.**

There may also be profit margins in any charges made for insured mortality or morbidity risks.

The Standard Provisions of the contracts specify whether the levels of charges can or cannot be increased. For those which can be increased, Harcourt Life would expect to implement such changes when justified, for example to reflect the change in the levels of administration expenses incurred, and the Inflation Index since the last such increase in charges.

7.2 (3) Harcourt Life would, if necessary, expect to consider taking action to increase charges for all policies where increase is permissible, to reflect any adverse changes in the external fiscal or regulatory environment.

7.3 (1) The charges currently applied are at the rates indicated in the original disclosure updated where applicable by increases since that date. The principal charge is the annual distribution charge which, for units in Series 2 and 5, is expressed as (15/85) %of the annual bonus percentage rate in a particular year applied to the value of the WPF, plus (15/85) % of the amount of any final bonus added to units cancelled. Moreover, if an MVR is applied to any units cancelled, *Harcourt Life* will pay (15/85) % of the MVR amount into the WPF (subject, in the case of some policies, to a maximum amount equal to the charges taken by *Harcourt Life* on those units prior to encashment), also discussed in section 4.5(3). For units in series 1, 3 and 4, the charge is respectively 1.25%, 1% and 0.65% of the nominal value of the units. The annual bonus rate is declared net of the annual distribution charge for all series in the WPF. The other charges are, strictly, not charges against the WPF; rather they are charges against the policy or contract.

These charges are at the rates disclosed in the marketing literature, updated according to the disclosed criteria from time to time.

7.3 (2) The actual charges currently being levied to policies are the same as the assumptions used in the model on which final bonus is assessed and those charged to the WPF in aggregate. As stated in 7.2(1) the charges levied are related to the level of charges disclosed at point of sale (up rated where appropriate), rather than to the actual costs incurred in managing the WPF.

7.3 (3) The charges levied are based on disclosed rates of charging, subject, in some cases, to periodic up rating. The charges are transferred out of the WPF and the corresponding actual expenses are then also borne outside the WPF. The charges are intended to include a margin to allow for Harcourt Life to operate these classes of business at a profit, with this profit accruing to the shareholder. Harcourt Life expects to continue with the current basis of charging, which is not based on actual costs, with the difference between charges levied and actual costs being a profit or a loss for the shareholder.

7.3 (4) The administration and investment management in connection with the policies in the WPF are outsourced. This outsourcing may be to connected companies in the LCCG Group or to third parties. Harcourt Life believes these agreements are currently on fair terms, and reviews these terms from time to time, but not to any fixed timetable. The current agreement for policy administration is with Utmost Services Ireland Limited, a connected company within the LCCG Group. The day to day administration of the policies is undertaken by DST a specialist outsourced service provider.

8. *Smoothing Account*

8.1 The fair market value of the assets in a with-profits fund may be more or less than the realistic value of the liabilities in the fund. Such an excess or deficiency is called a realistic surplus or realistic deficit. A realistic surplus is sometimes called an inherited estate.

8.2 (1) Harcourt Life currently intends to manage any balance in the *smoothing account* (which may be positive or negative) as part of the WPF and for the benefit of policyholders in that fund.

8.2 (2) Harcourt Life will distribute any balance in the *smoothing account* as an adjustment to the payout amounts available to policyholders aiming to pay out any positive balance and claim back any negative balance over a two-year period.

8.3 (3) The Practice in 8.2(2) means that the target level of the *smoothing account* is effectively zero.

8.2 (4) The implication is that Harcourt Life customers should expect payouts closely matched to *asset share*.

9. Volumes of New Business

The WPF is currently not open to new business and Harcourt Life has no plans to re-open the WPF, although it reserves the right to do so. The WPF continues to accept additional premiums to certain existing policies where there is an obligation under the policy conditions to accept such incremental premiums.

10. Equity between the WPF and the shareholder

10.1 Although most of the money in the WPF is earmarked for policyholders' benefits, the shareholder of Harcourt Life also has certain rights. This section of the PPFM aims to cover the approach to maintaining the balance between these potentially conflicting interests. There is, effectively, only one ultimate shareholder, as Harcourt Life is a wholly owned subsidiary of LCCG.

10.2 (1) The shareholder has no rights to participate in the profits of the with-profits business in Harcourt Life. The shareholder's rights are limited to taking the charges and fees discussed in section 7 above.

10.2 (2) Any proposal to amend the profit-sharing arrangements to the detriment of policyholders could be undertaken only after prior publicity to policyholders, discussion with Harcourt Life's regulators and, potentially, approval by the courts.

10.2 (3) Where the WPF seeks to rely on, or in reasonably foreseeable circumstances might seek to rely on support from the shareholder (and then if the shareholder has decided to provide support, which it is not obliged to do) then some constraints on WPF activity (for example on the investment strategy) are likely to be applied to give due weight to the interests of those (usually the shareholder) with alternative claims in normal circumstances on the funds providing support to the WPF. Any such constraints would be imposed only after a report from the Actuary and the agreement of the Harcourt Life Board.

10.3 (1) The current basis on which Harcourt Life divides profit in the WPF between policyholders and the shareholder is as described in 10.2(1) above - the shareholder's rights are limited to taking the charges and fees applicable to the policies, as described in section 7 above.

10.3 (2) The valuation and surrender bases do not affect the principle that the shareholder is not entitled to any transfer in respect of bonus added to the business. However, a factor which potentially affects the incidence of the charges taken by the shareholder is the levels of annual and final bonuses and market value reductions declared. This is because certain of the charges taken by the shareholder are based upon a percentage of the annual bonus rate declared, together with a percentage of final or terminal bonuses added and a rebate to the WPF of a percentage of any MVRs applied, as described in 7.3(1).

10.3 (3) The company is not currently writing new policies in the WPF, other than increments to certain existing policies where there is an obligation under the policy conditions to continue to accept such additional premiums.

10.4 As noted in Principle 10.2(3) above the shareholder is not obliged to provide support to the WPF and if any such support were to be provided in the future it would be on terms agreed at the relevant time between the shareholder, the Actuary and the Harcourt Life Board.