Principles and Practices of Financial Management (PPFM)

for Aviva Life & Pensions UK Limited Provident Mutual Sub-Fund

Version 18

AVIVA

Contents

Section 1: Introduction

The Introduction and any statements at the start of subsequent sections of this document, together with the appendices, are provided by way of background information and do not form part of the Principles or Practices.

1.1 Company information

Aviva Life & Pensions UK Limited ('the Company') (previously known as Norwich Union Life & Pensions Limited) is owned by Aviva Life Holdings UK Limited, whose ultimate holding company, Aviva plc, is incorporated in England.

Further information on the company names and background is provided in Appendix B.

Products are sold throughout the United Kingdom under the Aviva brand.

1.2 What business is covered by this document?

As a result of past Court transfers of insurance business, Aviva Life & Pensions UK Limited contains policies originally issued by a number of other insurance companies. The structure chart in Appendix C shows the composition of funds under Aviva Life & Pensions UK Limited.

This document covers with-profits business in the Provident Mutual Sub-Fund of Aviva Life & Pensions UK Limited (the 'Sub-Fund').

The most common names that exist on what are now policies of the Provident Mutual Sub-Fund are Provident Mutual Life Assurance Association, The Provident Clerks' Mutual Life Assurance Association and Provident Clerks' and General Mutual Life Assurance Association.

Other names will be relevant to policies in our other with-profits sub-funds. Appendix D contains a full list of all the original issuing companies, which will enable policyholders to identify whether this document applies to their policy or whether they should refer to the document for one of the other sub-funds.

1.3 Purpose of PPFM

What is a PPFM?

A PPFM is a document that sets out the Principles and Practices that a company follows when managing its with-profits business. The PPFM for this Sub-Fund has been approved by the Board of Directors of Aviva Life & Pensions UK Limited ('the Board'). The Board will report each year on whether each with-profits sub-fund has been managed in accordance with the PPFM.

What are Principles?

The with-profits Principles are enduring statements of overarching standards followed by a company when managing a with-profits sub-fund bearing in mind its duties to with-profits policyholders in both the current and future economic environments, its need to be fair to all policyholders, and comply with any relevant legislation and policy terms and conditions.

What are Practices?

The with-profits Practices provide more detail on the current approach taken by a company when managing a with-profits sub-fund.

Changes to Principles and Practices

If we propose to make a material change to any Principle in this PPFM we will inform policyholders with a with-profits policy in the Sub-Fund in writing at least three months in advance, unless we consider that advanced notice is not necessary and the FCA (one of our regulators) has agreed. Any proposed change to a Principle would be decided by the Board, having considered the views of the With-Profits Committee and having taken appropriate actuarial advice, including from the With-Profits Actuary.

Any proposed change to a Practice would be decided by the Board, having considered the views of the With-Profits Committee and having taken appropriate actuarial advice, including from the With-Profits Actuary.

Details of all changes to Principles and Practices will be displayed on the Company's website **aviva.co.uk/ppfm** as soon as possible after they are implemented. A link to the website page will also be included in annual statements.

Regardless of any such changes we will review this document at least yearly to ensure that it continues to accurately reflect the Principles and Practices we apply.

We would only change a Principle or a Practice when we consider the change to be justified by the need to:

- respond to changes in the business or economic environment;
- protect the interests of policyholders, for example to improve the fairness of a Principle;
- change a Practice to better achieve a Principle;
- correct an error or omission in the PPFM; or
- improve the clarity or presentation of the PPFM.

Whenever the PPFM is changed we will:

- document the changes and keep the previous versions of the document for at least five years; and
- ensure that any amendments to the Principles and Practices are compliant with all legal and regulatory requirements.

1.4 Governance arrangements surrounding the PPFM

It is the responsibility of the Board to ensure that the Company manages the Sub-Fund in line with the Principles and Practices set out in this document.

In line with regulatory requirements, the Company has put in place the following governance arrangements to offer assurance that PPFM have been adhered to:

- The Board will produce a 'With-Profits Policyholder Report' annually that includes information on compliance with the PPFM and the way the firm has exercised discretion and addressed any competing or conflicting rights and expectations. This will be made available to policyholders on the website **aviva.co.uk/ppfm** and on request.
- A With-Profits Actuary has been appointed to advise the Board on how it applies its discretion in managing with-profits policies. The With-Profits Actuary will report annually to the Board, and a summary will be available for with-profits policyholders as an Annex to the above annual report.

A With-Profits Committee, with a majority of independent members, has been formed to provide independent oversight and challenge to the Company to ensure that fairness and with-profits customers' interests are appropriately considered in the Company's governance structures and decision making processes. The committee has been formed under the FCA Conduct of Business Sourcebook requirements, and more details including its membership and terms of reference can be found on our website at **aviva.co.uk/wpcommittee**. The With-Profits Committee may also report annually to with-profits policyholders if it considers it appropriate. This would be made available to policyholders as an Annex to the With-Profits Policyholder Report mentioned above.

1.5 Court Scheme

The management of Aviva Life & Pensions UK Limited is also governed by a Scheme approved by the High Court of England in 2017, known as 'the Scheme'. In the event of any conflict between the terms of the Scheme and this document, the terms of the Scheme will take precedence. If we wish to change a Principle or Practice in this document, and it is directly related to a provision in the Scheme, then the Scheme would first need to be changed, which would normally require court approval.

The PPFM and the Scheme are not intended to alter the rights and obligations we have under any policy documents issued to policyholders.

1.6 Glossary

Appendix A defines the key words and phrases used within this report. The following section also gives some background information on types of with-profits policies and types of bonus.

1.7 Background information on with-profits policies

With-profits policies typically provide benefits at certain contractual dates specified in the policy. The contractual date is typically the end of the policy term, called the 'maturity date' for endowment policies or the 'retirement date' for pensions policies. For other policies such as with-profits bonds, the policy may specify particular contractual dates, for example the 10th policy anniversary. The benefits are also, typically, guaranteed on the death of the policyholder. Benefits may be taken at other times, but the payout received in this case is not usually guaranteed in any way.

Bonuses may be added to increase the value of the benefits of the policy. There are typically two forms of bonus:

- regular bonuses, which are added throughout the policy term, although at certain times the regular bonus may be zero; and
- final bonuses, which may be added whenever the policy benefits are taken. Again, the final bonus may be zero.

There are two types of with-profits policies:

- 'Conventional' with-profits ('CWP') policies typically provide a guaranteed amount of money on a set date or dates ('the contractual date(s)')and/or on death, provided that all the premiums are paid when due. The regular bonuses added from time to time increase the value of the initial guarantee set out in the policy. A final bonus may be added on the contractual date. Policies may be ended early, but the proceeds are then not usually guaranteed.
- 'Unitised' with-profits ('UWP') policies are different. Typically, each premium paid buys a number of units. Regular bonus may be added either by increasing the price of the units held and/or by adding extra units to the policy. Units may be cashed in at any time and a final bonus may be added. However, if the units are cashed in at any time that is not one of the contractual dates, a deduction called a 'Market Value Reduction' ('MVR') may be made from their value.

Not all policies receive the same bonus rates. For the purposes of setting bonuses, policies are grouped, mainly by type of policy. All policies in the group, known as a 'bonus series', will receive the same rate of regular bonus. The final bonus rates that apply to the group will typically depend on the year the benefits were purchased.

Section 2: The amount payable under a with-profits policy

Amount payable

2.1 Principles

The Board determines the appropriate level and timing of distributions to policyholders having taken appropriate actuarial advice.

The amount paid on maturity or death for a policy in the Sub-Fund will be the initial guaranteed benefits, plus bonuses constituting an equitable share of the distributable surplus earned by the Sub-Fund over the period of investment, subject to the policy conditions which take precedence.

Where a policy in the Sub-Fund is eligible for a surrender value, the amount paid on surrender will have regard to the initial guaranteed benefits and bonuses, and the desire to avoid surrenders causing a strain on the Sub-Fund remaining for continuing policyholders.

For the Dynamic Annuity, the amount of each annuity payment may include bonuses in addition to the guaranteed benefits. Where payable, these bonuses constitute an equitable share of the distributable surplus earned by the Sub-Fund over the period of investment. Annuity payments will be paid in accordance with the policy conditions.

Common bonus rates are used for appropriate groupings of policies reflecting an element of cross-subsidy and pooling of risks for policies with similar characteristics. A single group may contain policies of different type, age, year of entry, size and premium history.

In order to provide an element of stability in the returns to policyholders at maturity, smoothing is applied by spreading profits and losses from one year to the next. It is intended that the long-term cost of smoothing is broadly neutral, subject to the requirement to distribute the Sub-Fund equitably between policyholders. No such year-on-year smoothing is applied when reviewing surrender values. In between such reviews smoothing applies as described in the practices.

With the approval of the Board following the recommendation of the With-Profits Actuary:

- Different systems and different methodologies may be used for the purposes of determining bonuses for different types of business. The systems and methods used to determine bonuses or payouts may be changed from time to time as circumstances change including systems upgrades, or to improve the management of the bonus process. Approximate methods may be used where necessary, or if deemed appropriate:
  - where approximations are not expected to significantly affect the resulting bonuses or payouts, or
  - where the historical data required to perform precise calculations is no longer available or is difficult or costly to access. In this case the calculations will be carried out as accurately as is reasonably possible in the With-Profits Actuary's opinion.
- Historical assumptions and parameters used may be updated to support a change to the systems or to improve further the accuracy of the calculations.

2.2 Practices

Where practicable, asset share calculations for specimen policies are used as a guide to determine bonus rates and the amounts payable to policyholders. Asset share methodology is described in sections 2.3 and 2.4. The Board determines the appropriate level and timing of distributions to policyholders having taken appropriate actuarial advice. The bonus methodology has been established and refined over many years and will be further refined as required in future. For some small blocks of business where asset shares are not available or are inappropriate as a measure, we may use a comparable policy as a proxy to determine payouts or take account of past practice.

In order to distribute the Sub-Fund equitably between policyholders, the aim in the long term is to return to maturing policies, as a group, on average 100% of asset shares, adjusted for the proportionate size of the inherited estate. The amounts payable on maturity in any year, or to any particular with-profits investor may be more or less than this percentage target, due to the effects of smoothing, guarantees, and grouping of policies.

Current practice in determining bonus rates is to target an average payment on maturity for each group of policies equal to asset share, subject to the smoothing process. Maturity and surrender payouts for a group of policies should normally fall in the range 80% to 140% of asset shares.

Bonus rates are smoothed so that the full extent of changes in the market value of assets in the Sub-Fund is not always immediately reflected in claim payments. The aim is that in normal circumstances the cost of smoothing will be broadly neutral over the long term. There is no specific overall limit to the accumulated cost of smoothing beyond the principle of maintaining regulatory solvency at an acceptable level.

Our current practice is to limit the change in payout to be less that than the smoothing limit percentage when final bonus rates change.

The smoothing limit percentage used for a maturing policy depends on the value assuming that the current final bonus rates do not change.

- If the payout using the current final bonus rate lies within the target payout range (see above) then the smoothing limit is 5%.
- If the payout using the current final bonus rate lies outside the target payout range (see above) then the smoothing limit is 7.5%.

In normal circumstances, the maximum amount of smoothing in one year will be 15%. If circumstances change so that the solvency of the funds is threatened, then a larger smoothing limit percentage may be used, or smoothing may be suspended. The bonus philosophy practices provide more detail on the smoothing approach, see 2.6.

Over the long term the approach for non-guaranteed surrender values is to target an average payout of 100% of asset shares less any deductions required at surrender to protect the interests of remaining policyholders, subject to policy conditions. At present we do not make any deductions but may do so in future to the extent permitted within the Conduct of Business Sourcebook rules. For some policies, e.g. whole life, standard actuarial formulae may be applied as the use of asset share may not be appropriate. Where available, the directly calculated asset share for specimen policies will be used as a basis for calculating the amounts payable on surrender. Alternatively, a formulaic basis for surrender values may be used and factors may be applied to these values in order to achieve the asset share payout target on average. Individual policies may receive more or less than the average payout percentage of the group. The bases are reviewed when there is a 5% movement in underlying market indicators from when the bases were last changed and some sign of stability at that new level. In addition there would be a review when final bonus rates are changed. At any one time we may pay more or less than target due to changes in investment conditions.

Except for defined benefit pension schemes, a glide path approach is used to ensure that surrender values approach maturity values. The surrender basis and factors will be modified so that the surrender payout blends in to the expected maturity payout over a period of up to five years.

Whilst there are no formal smoothing practices on surrender equivalent to the smoothing applied to maturities we may choose to limit the maximum change in surrender values on a policy as a result of a review.

Supporting documentation of systems, methods, assumptions and parameters is maintained and is subject to formal change control procedures.

Any changes to systems, methods, assumptions or parameters are documented and are subject to formal change control with appropriate levels of authorisation. In particular, minor changes in assumptions would normally be authorised by the With-Profits Actuary. More significant changes in methodology and parameters would be agreed with the With-Profits Actuary and would be subject to the formal approval of the Board and subject to With-Profits Committee review.

The same assumptions and parameters are applied across different types of policies and across different generations of policies where, in the opinion of the Board, the experience of different groups is felt to be reasonably homogeneous or where the experience of different groups is not separately available.

For flexible endowment assurances past their early maturity date, the maturity value has interest based upon London Interbank Offered Rate (LIBOR) added to it monthly and when the benefits are finally taken, the accumulated value is uplifted by a final bonus. Shareholders receive a shareholder transfer of 1/9 the interest added and the final bonus.

For pension policies where the dynamic annuity benefit has been selected, and in payment dynamic family income benefits, the annual payment amount is increased each year by the relevant bonus rate.

For Deferred Allocation Funding policies, the amounts payable on bulk or individual exits from the Pension Scheme are determined in accordance with the policy conditions.

In the case of certain mortgage endowment policies subject to the Mortgage Endowment Promise, payouts may exceed the target percentages of asset shares described above. For such policies, a top-up payment in the form of an additional final bonus (extra to that described in sections 2.5 and 2.6) may be payable up to the maximum amount specified in policyholder mailings.

The Mortgage Endowment Promise applies to mortgage endowment policies maturing since 1 January 2000 where we have written to policyholders advising them of their maximum promise subject to certain conditions. These were:

- future investment returns on the inherited estate should be sufficient to meet the top-up costs
- the policy should not be sold to a third party
- policyholders should continue to pay premiums and not alter their policies in any material way.

The promise does not state that the mortgage amount will be paid if these conditions are met. It indicates a maximum top-up amount payable based on projections made in 1999. If the Company gets into a position where it does not think it can keep paying the full promise, the Company will give at least three years' advance warning that it cannot support all or part of these payments any more.

Asset share methodology

2.3 Principles

Where asset shares are used as a guide to determine the amounts payable under a policy they will reflect the relevant sources of profit or loss to the Sub-Fund applicable to with-profits policies.

The basis for the calculation of asset shares is to be one appropriate to a separate mutual UK life insurance company with no other business than that relating to its own policies. The practices currently used for the calculations are described in section 2.4.

2.4 Practices

Where asset shares are calculated, similar types of product may be grouped together. They are calculated for specimen policies or groups of policies from assumptions derived from the actual experience of the Sub-Fund. The experience may be measured across different generations or types of policies if it is considered appropriate by the Board, following the recommendation of the With-Profits Actuary. The approach is not used for altered policies; for these the bonus philosophy will follow similar unaltered policies.

The parameters and assumptions used are reviewed each year and changed where appropriate. Any changes are documented and are subject to formal change control procedures with approval of the With-Profits Actuary.

Asset shares are, in general, the accumulation of:

premiums paid (the premium history or an approximation to that if not fully known)

\+ an allocation of investment return

\+ an allocation (which may be zero) of miscellaneous profits/losses from the Sub-Fund

– the costs of selling and administering the business

– the cost of death or other risk benefits

– an adjustment for taxation appropriate for the class of business

– any contribution for the use of capital, provision of guarantees, glide path costs or smoothing

– (for dynamic annuities and income benefits) gross annuity payments.

This approach is described in more detail overleaf.

The Board, on the advice of the With-Profits Actuary, may include additional charges to asset share as appropriate.

Investment return

Until September 2013 the investment returns, for recent years, used in the asset share calculations, were based on the actual investment returns on assets hypothecated to back the with-profits business. The investment returns are now based on the returns achieved on a separate investment pool, as described in section 3.2.

The Board reserves the right to adopt different investment strategies for different policy types, in particular, for dynamic annuities and Deferred Allocation Funding contracts to reflect their different bonus structures and levels of guarantee, though it currently doesn't do so.

For earlier years where actual returns were unavailable, index returns and others have been used.

For with-profits policies where policyholders were offered and accepted the option, from 1 July 2005 until 30 September 2009 the investment return used in calculating their asset share was the CGNU investment return. From 1 October 2009, the investment return used is that of the Aviva Life & Pensions UK Limited Old & New With-Profits Sub-Funds.

Allocation of miscellaneous profits/losses

Prior to 1 January 1996 no allowance for profits on non-profit or linked business or profits from surrenders was made. From 1996 until 31 December 2001 approximate allowance was made for the excess of such profits plus investment earnings on the inherited estate over the cost of shareholder transfers; the allowance was in the form of a flat adjustment to the investment return for the year. From 1 January 2002 no allowance for these items is made except for an approximate allowance for surrender profits. Other profits are allocated to the inherited estate.

A charge for projected Guaranteed Annuity Option (GAO) costs may be made to the asset shares of classes of policy which have the option as follows. The inherited estate is first calculated making no allowance for such a charge to asset shares. The value of projected GAO costs is then offset against this inherited estate. If the inherited estate is insufficient to cover the total value of projected GAO costs, the excess is charged to the asset shares of those classes of business where GAOs are found. The amount charged to asset shares for each class of business is in proportion to the notional proportions of each premium which would be required to buy a swaption to hedge the GAO in respect of that premium (or annual premium increment at outset). The charge will be limited to no more than 10% of the asset share before reduction and is recalculated whenever bonuses are being determined. If the required total charge is in excess of 10% then only 10% will be charged to pension policyholders and the balance charged to asset shares of other classes of business up to a limit of 10%. If this is still insufficient to cover GAR costs then the Board will ensure the Sub-Fund remains solvent. For the avoidance of doubt, expected shareholder transfers are a liability of the inherited estate and will be assumed payable in determining whether GAO costs can or cannot be offset by the inherited estate. Policyholders effecting increments on pension policies would not expect their returns to be materially impacted by known residual risk within the Sub-Fund, for example GAOs. To this end, bonus policy for increments to pension policies will ensure payouts on increments since 1996 are not adversely affected by the cost of GAOs.

A charge may be made to the life asset shares on exit in respect of mortgage endowment mis-selling costs.

Currently no further allocations or charges are made to asset shares in respect of other miscellaneous profits or losses arising within the Sub-Fund.

Cost of selling and administering the business

The expenses of selling and administering the policies are allowed for in the asset share calculations.

Since 1996, the expenses (including investment expenses) have been in accordance with the various Court Schemes and Management Services Agreements that have applied (see section 5).

Before 1996, acquisition expenses assumed were those allowed for when profit-testing premium bases; maintenance expenses were derived from an analysis of those actually incurred.

Certain development expenses charged to the Sub-Fund are normally not charged to asset share but are instead met by the inherited estate, as decided by the Board with the approval of the With-Profits Committee from time to time.

Where a development is identified as clearly providing expected benefit to policyholders then a proportion of the cost may, subject to the agreement of the With-Profits Committee, be charged to asset shares. Where such charges have initially been applied to the inherited estate then when charged to asset shares a corresponding amount will be credited to the inherited estate.

Commission levels allowed for are equivalent to those paid on average.

Cost of death or other risk benefits

Mortality costs are charged to asset shares based on experience.

Adjustment for taxation

Appropriate allowance for income and capital gains tax is made in the investment return, for Life business. On income: the prevailing rate of policyholder tax is applied to the gross income yield. On capital gains: indexed gains are taxed at a policyholder tax rate allowing for the deferral of realisation. The tax currently charged to asset shares is consistent with the tax that is charged to the Sub-Fund, which is calculated as if the Sub-Fund were a stand-alone mutual life office.

Allowance is made for tax relief on expenses for Life business. The prevailing rate of policyholder tax is applied to gross expenses with allowance for any deferral of relief.

Any difference between the tax liability of the Sub-Fund and the aggregate tax allowances described above and contributions from the linked business are attributable to the inherited estate.

Cost of shareholder transfer

The cost of shareholder transfers is not charged to asset shares, but instead is met from the inherited estate. Such transfers are reduced by shareholder contributions to the Sub-Fund in respect of new dynamic annuities.

Tax associated with shareholder transfers is met by shareholders and not the Sub-Fund.

Use of capital

An additional charge may be levied on asset shares to reflect the provision of capital, guarantees and smoothing by the Sub-Fund, or to maintain the inherited estate or regulatory solvency of the Sub-Fund at appropriate levels. Currently this charge is zero. The death and maturity guarantee in respect of endowment business where the asset share has been reassured to obtain the Aviva Life & Pensions UK Limited Old & New With-Profits Sub-Funds (prior to 1 October 2009, CGNU) asset share investment return has been reassured to the Aviva Life & Pensions UK Limited Old & New With-Profits Sub-Funds.

Gross annuity payments

The value of annuity payments made on dynamic annuities and family income benefits are charged to asset share at the time they are paid.

Bonus philosophy

2.5 Principles

Regular bonus rates are set with the aim of providing a progressive build up of guaranteed benefits over the lifetime of the policy with an overarching aim of retaining sufficient profits to provide an appropriate margin for final bonus. Regular bonus rates may be changed to reflect circumstances including past investment performance, changes in expected long-term investment returns and any guarantees in the policies to which they apply. Regular bonus rates will be smoothed, to limit the change in these rates from year to year.

Different bonus rates may apply to different types of policy, for example, to reflect significant differences in investment mix, guarantees and charges, premium rates, policy types and series. New bonus series may be created in a variety of circumstances including in order to maintain equity between different policy classes, policies written under different premium rates and different generations of policyholders.

Final bonus rates are set with the aim of distributing the balance of the distributable surplus earned over the lifetime of the policy, to the extent that such profits have not previously been distributed by way of regular or other bonus additions plus an element, which may be positive or negative, of the inherited estate. Final bonus rates are smoothed as described in sections 2.1 and 2.2.

The Board may alter conditions for payment of final bonuses or to cease paying final bonuses at any time without notice. Factors that might lead to a change include changes in the financial circumstances of the Sub-Fund and anticipated future experience of an exceptional nature.

2.6 Practices

In determining future bonus policy the Board will have regard to:

- asset shares applicable to each category of Policy
- the bonus distribution policy of Provident Mutual before the policies were moved to be part of the Company
- the financial position and performance of the Sub-Fund from time to time
- the technical provisions of the Sub-Fund
- the value of the expected future surplus from unit-linked and non-profit business written in the Sub-Fund
- the capital requirements which the Sub-Fund would be required to maintain on a stand-alone basis (ignoring the minimum guarantee fund) allowing for the potential availability of waivers with respect to the use of implicit items.

In addition any new regulatory requirements would be taken into consideration.

Furthermore the Board will ensure that the inherited estate is applied progressively and equitably during the anticipated period of existence of the Sub-Fund in the provision of bonuses (allowing for shareholder transfers) with the aim of distributing all of the inherited estate by the time the last payouts on with-profits policies are made.

The paragraphs below describe how bonus rates are determined in normal financial circumstances. The Company may change these arrangements when circumstances are not considered normal. Examples of circumstances which would not be considered normal include a prolonged period of depressed asset values, a heavy incidence of surrenders, substantial business losses in the Sub-Fund, expected costs of guarantees or regulatory solvency issues.

The amount of regular bonus may depend on:

- the relevant profits earned in the Sub-Fund over recent years
- the investment return we expect in the long term
- the prospective final bonus margin
- the expected cost of guarantees on all existing with-profits policies in the Sub-Fund
- projected regulatory solvency levels, now and in the future.

Regular bonus declarations take into account the rates which the Company expects to be able to maintain over the terms of both existing and, where appropriate, new increments within a bonus series based on best estimates. This is achieved by projecting current asset shares for specimen policies each year for a range of future investment returns on the Sub-Fund, and choosing a target regular bonus rate which aims for an adequate margin for final bonus. The projections allow for potential variations in the future investment returns. Suitable allowance will be made to finance final bonus to reduce the risk of asset shares falling below initial guaranteed benefits plus previously declared bonuses. Part of the profits are shared out as regular bonus. We aim to do this so that there is an appropriate balance paid as an additional or a final bonus, taking account of the overall strength of the Sub-Fund. At any time we may pay more or less depending upon actual experience.

No undue weighting is given to recent economic experience.

Interim bonus rates, where appropriate, are determined having regard to the estimates of the level of regular bonus rates expected to be declared at the next declaration.

In normal conditions, regular bonus rates will be reviewed once a year. Although changes are smoothed, there is no maximum amount by which regular bonus rates would alter.

Final bonus rates are set to achieve the overall aim of returning to maturing with-profits policyholders, as a group, on average 100% of asset shares in the long term, given the regular bonus rates determined as described in section 2.5 and 2.6. They are set so as to achieve the smoothing objectives described in section 2.2. Representative specimen policies are used, rather than the underlying policy asset share itself. Final bonus rates are influenced by the total return on investments and so are reviewed in the light of prevailing financial conditions. In normal circumstances, the Company will aim to limit the recovery of past smoothing costs to 5% of asset share.

In normal conditions, final bonus rates will be reviewed at least twice a year. However, we may change final bonus at any time during the year, particularly in changing financial conditions. We expect to change final bonus rates when there is a sustained movement in asset shares of 15% or more since final bonus rates had last been set. Final bonus rates are currently based on calendar year of entry.

Final bonus – where applicable – is payable on all claims arising on death, maturity and retirement under the terms of the policy. On surrender, an allowance for final bonus – where applicable – is made in the formulaic basis. Final bonus may be zero.

The Company reviews the returns provided to policyholders by their with-profits policies and, where considered appropriate, may increase the benefit of smoothing for some groups of policies by increasing the final bonus paid. Such instances are limited, and would be subject to Board approval, having regard to the advice of the With-Profits Actuary and review by the With-Profits Committee. Where this practice is applied, it is done so it has no material adverse effect on other with-profits policyholders.

From time to time special bonuses have been declared on certain policies. These bonuses represent a consolidation of part of the final bonus otherwise payable on death and maturity claims. Special bonuses are less likely to be a feature of the bonuses in the future as the level of asset growth is expected to be lower. There was also a one-off demutualisation bonus funded by a capital injection by shareholders.

For dynamic annuities and dynamic family income benefits in payment, a regular bonus continues to be declared in payment which is determined by calculating what constant rate of bonus in the future would be supported by asset shares for groups of annuities making assumptions about future experience. For pre-1983 dynamic annuities where the historical data required to perform precise calculations is no longer available or is difficult or costly to access, the rate used is one consistent with later years and bears in mind the risk of future mortality improvements.

For Deferred Allocation Funding policies, an additional bonus has from time to time been declared at the start of a calendar year to be added to the Fund Account at the following annual renewal date under certain conditions. Additional bonus when declared is not subject to smoothing from year to year but has been used to give a more equitable allocation of bonus.

For flexible endowment assurances past the early maturity date, bonus interest based on LIBOR is added to the value of the policy each month. The final payment has a bonus uplift. This uplift amount is regularly reviewed and may be liable to change.

The bonuses described in this section also apply to investments that have been altered in some way and/or stopped payment of premiums.

Section 3: Investment strategy

Introduction

Information (which has previously been made publicly available) on the mix of assets and investment returns in recent years is given on the Provident Mutual Sub-Fund investment information sheet which is available on the website aviva.co.uk/ppfm.

3.1 Principles

The Company endeavours to pursue an investment policy in the best interests of the policyholders subject to normal considerations of prudence and subject to taking appropriate advice including that of the With-Profits Actuary. The With-Profits Actuary has regard to the reserving requirements of the Sub-Fund and the capital requirements in which the Sub-Fund would be required to maintain on a stand-alone basis.

The investment strategy aims to provide the highest long-term returns commensurate with acceptable levels of risk, having regard to:

- the nature and term of the with-profits liabilities and the management of cash flows
- the current and expected level of guarantees
- regulatory solvency requirements
- the size of the inherited estate and any freedom or restrictions in investment flexibility that it may provide
- short-term and long-term anticipated returns in different asset classes
- volatility of different asset classes
- advice from our Fund Managers.

The monies of the Sub-Fund will be invested in a range of assets where this reduces risk. Target investment returns are set relative to appropriate indices, taking into consideration the levels of risk inherent in each asset class and stock. Maximum and minimum exposures to, and performance benchmarks for different investment classes and/or individual investments will be set from time to time in accordance with Sub-Fund objectives. Maximum exposures to investments in any one counterparty will be specified. Intended holding ranges in various investment classes may be changed in order to improve long-term performance or to improve the likelihood that the Sub-Fund can meet its guarantees.

Investments may be made in derivatives or similar instruments if they are appropriate to the objectives of the Sub-Fund. Such investments are subject to the appropriate internal governance procedures of the Company.

The Company maintains a separate register of assets for the Sub-Fund, which is credited with the income and gains on those assets. The investment strategy for the Sub-Fund is determined according to the composition of the Sub-Fund alone.

The Sub-Fund may have recourse to the assets in the Shareholder Fund, should this be necessary in order to meet guarantees or to give more freedom to the Sub-Fund though this is entirely at the discretion of the shareholders.

The investment strategy of the Sub-Fund takes into account the nature and term of the liabilities, by considering appropriate assets for different classes of with-profits policy and different generations of with-profits policyholders. No other investment constraints are placed on parts of the Sub-Fund, other than those detailed in the rest of this section which apply to the entire Sub-Fund. In respect of its investment strategy, the Sub-Fund will not be treated unfairly compared to other sub-funds.

3.2 Practices

Aviva Investors Global Services Limited is currently the main appointed Discretionary Fund Manager (‘the Fund Manager’) for the Sub-Fund excluding Commercial Mortgage assets managed by Aviva Commercial Finance Limited. An investment management agreement exists between the companies which sets out investment strategy and guidelines. The Board appoints committees to manage the relationship with the Fund Managers, set the strategic direction and review performance against benchmarks. Their activities include: agreeing the appointment of Fund Managers, investment management agreements, credit and counterparty limits and approving major and special investment decisions. These committees are responsible for determining the benchmark asset allocation strategy, setting risk appetite and reviewing both competitor activity and economic outlook alongside expected returns on different asset classes (short term and long term).

The assets of the Sub-Fund are predominantly invested in equities, property, fixed-interest securities and cash. The Board sets investment performance targets for the Fund Manager:

- For asset category allocation (e.g. UK equities, property, fixed-interest securities), the following are set:
  - performance targets relative to benchmark indices
  - benchmarks and asset allocation ranges for all classes of assets.
- For stock selection within asset categories:
  - performance targets have been set for all sector funds. For Life and Pensions business, outperformance target ranges have been set against appropriate benchmark indices
  - to control the risk profile of the equity sector funds, a tracking error is set at a multiple of the performance objective recognising the expected skill levels of the Fund Manager
  - to control the risk profile of the bond funds the duration and tracking error ranges are set using the same approach as for equity sector funds.

Currently, there is no recourse to assets in the Shareholder Fund in order to support the investment strategy of the Sub-Fund, as described in section 3.1.

Assets used to generate the rate of investment return to be credited to asset shares are managed in an investment pool that is separate from the remaining assets of the Sub-Fund. These remaining assets of the Sub-Fund generate returns appropriate for the inherited estate liabilities associated with them (i.e. non-profit liabilities, guarantee costs in excess of asset shares and any other residual inherited estate item).

The investment pool for the inherited estate includes fixed interest and derivatives that allow efficient management of the portfolio and help manage market risks faced by the inherited estate of the Sub-Fund. This asset mix is regularly reviewed to ensure it is appropriate given the market and liquidity risks faced.

The investment pool used to generate the rate of investment return to be credited to asset shares is smaller than the asset shares. This does not mean that there are insufficient assets to meet the liabilities. It means that there is a short position that provides a natural hedge from equity and property movements and is part of the approach to managing the risks faced by the Sub-Fund.

The target asset allocation is regularly reviewed, usually every three years or following a significant change to market conditions or the financial position of the Sub-Fund. The need for a review is assessed annually. Short term tactical decisions may also be made, having taken account of appropriate actuarial advice and having regard to fairness towards policyholders. Allocations between asset categories can be varied by the Fund Manager within tight constraints and the result of this activity is reviewed monthly by the relevant committee.

For with-profits business, a suitable proportion of equity type assets, known as the equity backing ratio (EBR) is maintained for asset shares within the Sub-Fund. This is calculated to allow for the cost of guarantees on policies within the Sub-Fund and takes into account the strength of the Sub-Fund and the size of the inherited estate. Currently, the same EBR is used across all classes of with-profits policy written in the Sub-Fund, with the exception of those receiving the Aviva Life & Pensions UK Limited Old & New With-Profits Sub-Funds (formerly CGNU) investment return in calculating the asset share, though the Board retains the right to change this position.

Whilst we either seek or accept some market risks, including credit risk, within the inherited estate we aim to limit exposures to interest rate, inflation and currency risk.

The method currently used to determine asset allocation ranges for broad asset classes (equity type and fixed interest) and duration ranges for fixed-interest assets is as follows:

- Theoretical EBRs are determined separately for aggregate asset shares plus guarantees and any remainder of the Sub-Fund (This remainder is generally small in view of the closed nature of the Sub-Fund and the requirement to distribute any inherited estate over the remaining lifetime of existing with-profits policies.) This is taken as an assessment of the maximum exposure to equity assets that can currently be supported. The assessment is performed by asset liability modelling techniques.
- The Board, through its investment committee, decides on the strategy for the remainder of the Sub-Fund and has discretion to depart from the theoretical EBRs. For instance it may take into account:
  - the asset distributions of other with-profits funds or companies
  - its view of the outlook for different categories of investment
  - the projected trend of EBRs.

Asset allocation ranges to be specified to the Fund Manager are then determined based on the overall EBR as agreed by the investment committee.

The Sub-Fund does not invest in properties used by Aviva Life Services UK Limited or any Aviva group offices.

The use of derivatives in the Sub-Fund is set out in the investment management agreement and is otherwise subject to approval through the appropriate internal governance procedures regarding the use of derivatives. These governance procedures seek to control the risks in using such contracts, and therefore consider amongst other things:

- the types of exchange-traded and over-the-counter derivative contracts which may be used
- maximum gross exposures which may be held in each derivative type.

The total exposure to an asset class within a Sub-Fund allowing for derivatives must be within the benchmark asset allocation ranges specified for that Sub-Fund in the investment management agreement unless otherwise agreed by the relevant committee.

Derivatives are used to hedge the financial exposures of policyholders and shareholders. The uses of derivatives that are permitted are:

- efficient portfolio management
- reduction in investment risk.

Appropriate credit quality of the investments of the Sub-Fund is maintained by prescribing benchmarks for the credit ratings in the investment management agreement.

The Sub-Fund invests predominantly in quoted investments in order to maintain the liquidity quality at a high level. The investment management agreement specifies limits on the level of investment in unquoted securities. Cash and deposit-type investments are also used to back current liabilities to provide a greater level of liquidity within the Sub-Fund than would otherwise be achieved by investing solely in longer-term assets.

The flexibility to use new investment instruments will be balanced with the need to identify the risk inherent in them and to ensure that they will be subject to adequate controls before their acquisition. No investments will be made in new investment instruments unless a proposal has first been made and approved by the Board or the committee responsible for investment strategy.

As part of the investment management activities we may lend some assets of the Sub-Fund to selected financial institutions to generate additional fee income from the Sub-Fund. All revenue derived from this process is passed directly to the Sub-Fund less any associated cost incurred. In certain circumstances, for example, if the institution encountered financial difficulties and was unable to return lent assets, the Sub-Fund could suffer a loss. We have, however, in place a number of controls, such as always obtaining security from each borrower as well as monitoring their credit ratings, in order to reduce the risk to the Sub-Fund.

There are no strategic investments currently nor is it the intention there will be any in the future.

Section 4: Business risk

Introduction

The with-profits policyholders are entitled to a share of any distributable surplus of the Sub-Fund as determined by the Board and are exposed to the general business risk of miscellaneous profits and losses that may arise from various sources within the Sub-Fund.

4.1 Principles

In addition to business risks arising from existing business, the Scheme requires the Sub-Fund to accept further business risks in relation to incremental new business, including business written as a result of the exercise of policyholder options. The Sub-Fund does not accept other new business risks.

The Sub-Fund may make investments in accordance with applicable legal and regulatory requirements.

The Sub-Fund will not provide financial support to other sub-funds of the Company.

Control of existing business risk is exercised through the Company's governance arrangements which include regular monitoring of all significant business risks. Processes are established to determine the impact of the various business risks, for example insurance, market, credit, liquidity, operational, on the financial position of the Sub-Fund and where necessary to identify and implement appropriate mitigating actions.

Where compensation costs from a business risk will be borne depends on the nature of the compensation and the need to ensure fairness of treatment between policyholders and shareholders.

4.2 Practices

In general, when considering whether to undertake a business risk the Company will consider:

- existing business risks
- potential rewards to policyholders and shareholders
- potential rewards to policyholders and shareholders of alternatives including risk-free investments
- size of, and possible impact on the Sub-Fund and inherited estate.

The Company's procedures for deciding what terms to offer for incremental new business, where the basis is not guaranteed under the policy, are as follows: the profitability of a range of policies written on the proposed terms is projected on a standard set of assumptions regarding future experience. Profitability measures are compared against approved hurdles to test acceptability. Sensitivities are also calculated by recalculating the profitability of the policies on alternative sets of assumptions designed to establish the impact of adverse experience in each of the most significant areas of business risk. If these are acceptable the With-Profits Actuary approves the terms.

The Board regularly reviews risks to which the Sub-Fund is subject. It carries out a full review of such risks each year, including projecting the Sub-Fund's business over time under a variety of assumptions. As a result of this process the Board may implement measures to reduce or limit risks. Such measures may include changes to investment strategy, hedging, and to the terms on which incremental business is written.

Exposure to operational risk is limited because, under the Scheme, Aviva Life & Pensions UK Limited is responsible for administration of the Sub-Fund. Compensation costs arising from maladministration are paid by Aviva Life Services UK Limited in accordance with the Management Services Agreement as agreed by the Board following the recommendation of the With-Profits Actuary. Compensation costs in respect of misselling of mortgage endowment business will be charged to asset share for all endowment business.

Exposure to group risk is limited because the Scheme requires the Sub-Fund to be administered in many respects in isolation from other business of the Aviva group, and because the Sub-Fund is closed to new business. The Sub-Fund does not provide financial support to other sub-funds of the Company.

Business risk may arise from the issue of capital instruments by Friends Life Holdings plc ('FLH') and Aviva plc with the benefit of a subordinated guarantee from the Company or from the issue of capital instruments by the Company to FLH. However, in both cases, this risk is substantially mitigated because the Sub-Fund is managed (and the capital instruments are structured) so that discretionary benefits under with-profits insurance policies are calculated and paid, disregarding, insofar as is necessary for policyholders to be treated fairly, any liability the Company may have to make payments under the capital instruments or guarantees. Payments under these instruments are not subordinate to the Solvency Risk Appetite, and circumstances could arise in which payments were required to be made in relation to the instruments which reduced excess capital in the Company below the Solvency Risk Appetite (or which further reduced it if it was already below that level). However, this risk is currently mitigated by the strategy and planning business standard which would be expected to require a plan for debt repayment, in particular payments due within the next three years and a requirement for the With-Profits Actuary to report annually to the With-Profits Committee on the impact of the Company's plans, including debt restructuring and repayment, on policyholder security.

The treatment of profits or losses from business risks as regards asset share calculations and the inherited estate is covered in sections 2.4 and 6.2 respectively.

The general approach to the smoothing of profits or losses from business risks to the extent that these are a determinant of amounts payable under with-profits policies is described in section 2.4.

There is no specific minimum level of profit or loss from business risks before the Sub-Fund will treat them as a determinant of the amounts payable under with-profits policies. The Board reserves the right to review this policy. Losses which are currently borne by the inherited estate may in future be applied to with-profits policies where, in the opinion of the Board (on the advice of the With-Profits Actuary), such action is required to maintain the regulatory solvency and the inherited estate at an appropriate level.

Except where stated otherwise in section 2.4, profits or losses from business risks are currently pooled across all with-profits policies. Should losses which are currently borne by the inherited estate be applied instead to with-profits policies, it is likely that a degree of differentiation will be made. The particular classes or generations of policies which will bear such losses will depend on the nature of the loss and the circumstances at the time.

Other than compensation costs in respect of maladministration, compensation costs from a business risk will be borne by the inherited estate unless it is determined by the Board that they should be borne by policyholders through a charge to asset shares.

Section 5: Charges and expenses

5.1 Principles

The Company has outsourced its administration, distribution and development functions to Aviva Life Services UK Limited, which is a company wholly owned by Aviva Life Holdings UK Limited. A Management Services Agreement (MSA) governs this arrangement, which includes business within the Provident Mutual Sub-Fund. The Company charges the Sub-Fund for administration services in accordance with the provisions specified in the Scheme. The standard of service should be equivalent to the standard of similar services provided to any other sub-fund of Aviva Life & Pensions UK Limited.

Administration expenses will be allocated on a combination of fixed and per policy fee basis as set out in the current MSA. The current MSA has been in place since 1 January 2009 and will continue in force until 31 December 2018. This is subject to adjustment if, in the reasonable opinion of the Board, having obtained appropriate actuarial advice and subject to prior approval of the With-Profits Committee, the basis for allocation of expenses to the Sub-Fund which would otherwise apply would not over time be fair to policies allocated or reassured to the Sub-Fund.

When the time arises we expect to use a basis consistent with that then used by other sub-funds and companies within Aviva Life Holdings UK Limited, subject to a market test.

The expense basis cannot be changed unless the Board, following the recommendation of the With-Profits Actuary and an independent actuary, each certify in writing that in their respective opinion the proposed amendment is necessitated by exceptional circumstances (including changes in legislation or levels of taxation) having a material impact on the costs of operating or administering the Sub-Fund and that such amendment will protect as far as possible the reasonable expectations of the holders of transferred policies (taking into account statements made in the Circular to policyholders at the time of transfer in connection with the Scheme and the provisions in the Scheme). Our regulator would require to be supplied with the certificates and approve the amendment.

5.2 Practices

In 2007, Aviva Life Services UK Limited entered into an agreement with Swiss Re to administer part of the business. The migration of the relevant Aviva Life Services UK Limited policies commenced in 2008. The MSA with Swiss Re details the charges and service to be provided. There are some retained services and overheads in respect of the migrated policies still managed by Aviva Life Services UK Limited.

A new MSA is in place from 1 January 2009 in respect of policies administered by Aviva Life Services UK Limited. In developing the new MSA, independent consultants were engaged to provide benchmarking data and to advise the With-Profits Committee on the fairness of the terms.

The MSA can be terminated prior to the contractual end date by either party if the other party is deemed to have defaulted, e.g. by failing to perform any material obligation or failing to make punctual payments due, or it can be varied by mutual agreement.

Under the MSA, Aviva Life Services UK Limited charges fees to Aviva Life & Pensions UK Limited for the services provided associated with running the Sub-Fund business, e.g. administering and distributing policies. The charges are based on the underlying expenses incurred with the exception of administration (described below) which are based on agreed fee scales. These charges are then passed on to the Sub-Fund.

Administration fees for new and existing business expenses are a combination of per policy and fixed with inflationary increases. The fixed fee will be reviewed after 5 years, or earlier if the actual in force volumes of Aviva's with-profits business varies by more than 15% from those expected. Fees each month are based on estimated policy volumes, with a true-up payment being made each year within 6 weeks of the year end. A reduction of 6.2% in new business expenses in respect of new with-profits immediate annuities (dynamic annuities) written in the Sub-Fund is also applied, either as a reduction in expense charges, or by reducing shareholder transfers.

The MSA defines the level of service to be provided and the steps to be taken should standards achieved fall below the defined levels. The scope and standard of service may be adjusted to align with the level of administration fees, taking into account the financial position of the Sub-Fund and the volume of policies in force as well as the obligation to treat policyholders fairly.

Fees for developments requested by Aviva Life & Pensions UK Limited are based upon agreed costs. These will be charged to the Sub-Fund to the extent that these will benefit the Sub-Fund in the future and/or are to cover regulatory requirements.

Fees for Investment Management will be those charged to Aviva Life & Pensions UK Limited by the Fund Manager which reflect market terms adjusted for the size of the investment portfolio and their being a connected party, in line with the investment management agreement.

These charges are then passed on to the Sub-Fund where they relate to Sub-Fund assets.

Fees for regulatory fees and industry levies which are incurred by Aviva Life Services UK Limited and which are directly attributable to the Sub-Fund are charged to the Sub-Fund at cost. Fees are also adjusted to allow for any surplus emerging from the PM pension fund.

Fees for polices administered by Swiss Re are incurred by Aviva Life Services UK Limited and charged to Aviva Life & Pensions UK Limited at cost. Expenses for retained services and overheads are charged by way of a combination of fixed and per policy fees. These charges are then passed on to the Sub-Fund where they relate to policies of the Sub-Fund.

The service agreements between the Sub-Fund and Aviva group service companies transfer risk from the Sub-Fund to the service company. The risks transferred relate to falls in the volume of business and increases in expenses. The fees agreed with Aviva group services companies will include a risk loading to allow for this. If the risk does not emerge, the risk loading will fall into the profit of the Aviva group services company.

Apart from fees under management services agreements and in respect of investment fees, development expenses, regulatory fees and industry levies, no further expenses will be charged to the Sub-Fund unless the Board having taken account of appropriate actuarial advice considers this to be consistent with the interests of policyholders.

Tax is allocated to the Sub-Fund as though it were a stand alone mutual fund.

Section 6: Management of the inherited estate

6.1 Principles

In its management of the Sub-Fund's inherited estate, the Board will ensure that it is applied progressively and equitably during the anticipated period of existence of the Sub-Fund in the provision of bonuses (allowing for shareholder transfers) with the aim of distributing all inherited estate by the time the last payouts on with-profits policies are made. (This is referred to in section 2.5 and 2.6.)

Subject to the paramount requirements above, the inherited estate may be used at the Board's discretion to:

- provide a cushion of additional security against unexpected adverse events
- permit flexibility in the smoothing of maturity and surrender payouts for policies
- meet shareholders' transfers
- meet such other purposes as permitted by law and consistent with the Company duty to maintain adequate financial resource.

6.2 Practices

As well as the uses described in the Principles above, the inherited estate is currently used to pay:

- any financing of smoothing of payouts (over the longer term the cost of smoothing is expected to be neutral)
- costs arising from the Mortgage Endowment Promise
- guarantee costs where these exceed the policy value indicated by asset share.

In addition the inherited estate may be used to pay other costs as agreed by the Board, following the recommendation of the With-Profits Actuary.

The investment strategy for the inherited estate may differ from that of the rest of the Sub-Fund.

The Sub-Fund is managed so that the risk of assets failing to exceed liabilities is small. There is a preferred range for the estate, the bottom of which is set such that the level of risk over 1 year (that assets would fail to exceed liabilities) is broadly equivalent to 1 year historic default probabilities on AA rated corporate bonds. The top of the preferred range is broadly 135% of the bottom of the preferred range. The top of the preferred range is known as the AAA Capital Threshold (AAA CT).

Discretionary distributions may be made from the inherited estate in accordance with the Risk Appetite Framework and referencing the preferred AA to AAA range. The Board will determine whether such distributions should be made subject to the rules of our regulator, the fair treatment of policyholders, having consulted the With-Profits Committee and having regard to the advice of the With-Profits Actuary.

We will no longer use the inherited estate to pay the small outstanding amount of pensions compensation liabilities in respect of the pensions review, or the shareholder transfers of 1/9 of these liabilities.

When the assets of the Sub-Fund (excluding those backing non-profit policies) fall below £50m, we may declare a scale of guaranteed benefit increases to be added in future years to exhaust the surplus in the Sub-Fund. The policies will then become non-profit policies and any future profit or loss arising from them will fall to the Non-Profit Sub-Fund of which they will then form part.

We may also at any time merge any with-profits sub-funds with any other sub-fund, with-profits or non-profit, or sub-divide any with-profits sub-fund, provided that appropriate actuarial advice has been taken, the With-Profits Committee has been consulted and we are satisfied that the merger takes account of our duty to pay due regard to the interests of its policyholders and to treat them fairly.

Section 7: Volumes of new business and arrangements on stopping taking new business

In accordance with the Scheme, no new business is written in the Sub-Fund except for incremental business and business written following the exercise of options on existing contracts which the Scheme requires the Sub-Fund to accept.

Section 8: Equity between the Sub-Fund and shareholders

8.1 Principles

In accordance with the Scheme we will apportion not less than 90% of the distributable surplus of the Sub-Fund for the benefit of with-profits policyholders. The remainder of the distributable surplus is transferred to shareholders.

As an overarching Principle, the Company reserves its right to proceed with any reorganisation or transfer of business or merging or dividing or closing the Sub-Fund or any combination of the above in accordance with any legal or regulatory requirements.

8.2 Practices

Since demutualisation the transfer made to shareholders has been at the maximum permitted level.

For calculating shareholder transfers, declared profits and the cost of new bonuses are discounted to allow for the period until it is due for payment i.e. on death or maturity of the policy. If the basis used for the discounting changes, the amount allocated to shareholders would also change. The cost of bonuses used in the calculations includes any distributions made in anticipation of a surplus in the form of final or interim bonuses.

The pricing of incremental new business is in no case significantly reducing the inherited estate if the shareholder transfer is taken into account.

Appendix A: Glossary

Amount paid on death

The total amount payable if the insured person dies while the policy is still in force.

Amount paid on maturity

The total amount payable at the date originally agreed as being the termination date of the policy if it is still in force at that time.

Amount payable on surrender

The total amount payable if the policyholder decides to cash in (or transfer in respect of a pension) the benefits at a date other than the originally agreed termination date.

Annual management charge

A deduction made from unitised with-profits policies to cover administration and investment management expenses. This is either taken explicitly by the cancellation of units or implicitly being built into the bonus rate declared.

Appropriate actuarial advice

'The Board having taken account of appropriate actuarial advice' means that the Board has taken such internal actuarial advice as the Board decides in the context of the relevant matter, which must always include the advice of the With-Profits Actuary in matters relating to the security or benefit expectations of holders of with-profits policies. The Board may also in its absolute discretion obtain external actuarial advice, and in this case, the reference shall be to the Board having also taken account of that external actuarial advice.

Asset share

The premiums paid, less deductions for expenses, guarantees, tax and other charges, plus any allocations of business profits, accumulated at the investment return achieved on relevant assets of the Sub-Fund.

Benchmark

The standard position, for example, for the percentage of assets to be held in equities, fixed interest and property and against which any difference would be measured for assessing performance of investment managers.

Conduct of Business Sourcebook (COBS)

The **FCA** and **PRA** produce various business standards rulebooks which provide the detailed requirements relating to firms day-to-day business. One of these rulebooks is the Conduct of Business Sourcebook which sets out the requirements applying to firms with investment business customers.

Conventional with-profits

Life and pension policies written with an initial guaranteed benefit and all charges are allowed for within the premium rates. The policies are invested in the Sub-Fund and share in the return of the Sub-Fund through the addition of bonuses.

Counterparty

Investment contracts impose an obligation on both parties to meet with the terms of the contract. The other party is known as the counterparty.

Counterparty limits

The company set limits on the amount of investments a company can have with a particular counterparty. This prevents excessive exposure to one company and the risk that would entail.

Credit limits

These are the limits within which a type of asset may be held with reference to the underlying credit rating (e.g. AAA).

Credit rating
This is an independent, relative assessment of financial risk, e.g. Standard and Poor's.

Efficient portfolio management
This is the construction of an asset portfolio so as to achieve the maximum expected return for a given level of risk.

Endowment assurance
A life assurance plan that pays a sum of money on the survival of the life assured to a specific date, or upon their earlier death, in return for regular premiums or a one-off payment.

Equity Backing Ratio (EBR)
The proportion of assets backing asset shares invested in equities (company shares), property or other assets that are considered to have a similar level of expected return.

FCA
The Financial Conduct Authority (FCA) regulates the financial services industry in the UK. Its aim is to protect consumers, ensure the industry remains stable and promote healthy competition between financial services providers. The FCA and PRA replaced the FSA when they were given their powers by the Financial Services Act 2013.

Final bonus
This may be added to investments in the Sub-Fund when a claim arises. The final bonus is not guaranteed and may be changed or removed at any time.

FSA
The Financial Services Authority (FSA) was an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. It regulated the financial services industry in the UK until 2013 when it was split into two separate regulatory authorities, the **FCA** and the **PRA**.

Glide path
Sometimes payouts on maturity, retirement or earlier surrender are at a level above or below that justified by asset shares. This happens as a result of the smoothing of investment performance, a feature of with-profits policies. The planned smooth progression of payouts back to the level of asset shares is known as the glide path. This can also refer to the mechanism designed to ensure that surrender values blend into the expected maturity payout, as the context requires.

Group of policies
Unless stated otherwise or the context suggests otherwise, a group of policies is defined as a group of similar policies for which we declare the same final bonus so that the appropriate percentage of asset share is paid.

Hedging
Specific investments can be made to reduce the risks with a particular asset or liability. This is known as hedging.

Inherited estate
The inherited estate is the excess of assets held within the Sub-Fund, over and above the amount required to meet the liabilities. The assets over and above the assets backing guarantee costs in excess of asset shares are sometimes known as the realistic inherited estate. The liabilities, for this purpose, include those that arise from the regulatory duty to treat customers fairly in setting discretionary benefits, such as final bonuses. The inherited estate acts as working capital of the business. It is used to support the business by, for example, providing investment flexibility and a 'cushion' against adverse stock market conditions.

Initial guaranteed benefits
When a conventional with-profits policy is taken out the policy defines a basic benefit that is guaranteed to be paid at maturity or earlier death or other specific times (together with any bonuses declared subsequently on the policy) as long as all premiums are paid when they are due and the policy is kept in force.

Interim bonus
Where a regular bonus rate has only been declared up to a certain date, then an interim bonus covers the period before a next declaration for claims made during that period.

Management Services Agreement

This is the agreement under which the service company, Aviva Life Services UK Limited, provides management and administration services to the life company.

Maturity date

When an endowment policy is taken out there is an agreed date, the maturity date, when the benefits will be paid so long as the policy is kept in force. For a pension policy it is the selected retirement date at commencement of the policy.

Mortgage Endowment Promise

This applies to all notified with-profits mortgage endowment policies where there was a shortfall between the projected amount at maturity (at a rate of 6% per annum net of tax) and the target mortgage amount as at 31 December 1999.

Mortality costs

These are the cost of providing life cover over a specific period.

Mortality rates

These are the expected or actual proportions of people dying at a certain age.

Pooling

The sharing of investments or risks between sub-funds or parts of sub-funds.

PRA

The Prudential Regulation Authority (PRA) is a part of the Bank of England and responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm. The FCA and PRA replaced the FSA when they were given their powers by the Financial Services Act 2013.

Quoted/unquoted investments

Quoted investments are those for which there is a regular price quoted, usually on one of the world's stock markets. These then have an easily assessed point in time value and ability to trade. Unquoted investments are not part of an organised market and so may be more difficult to value or trade.

Regular bonus

This is the distribution of surplus added to the policy each year. For conventional with-profits policies this is done by allocating a bonus which increases the amount guaranteed to be paid on death and, if the investment has a maturity date, at the end of the term.

Regulatory solvency

The required minimum level of assets in excess of liabilities including any required regulatory buffer.

Scheme

All references throughout this document refer to the Scheme of transfer of policies and assets from Friends Life Limited and Friends Life and Pensions Limited to Aviva Life & Pensions UK Limited on 1 October 2017.

Shareholder Fund

Assets held within the Company that are not within the with-profits sub-funds or the Non-Profit Sub-Fund. The assets of this fund are available to meet the Solvency Risk Appetite and, to the extent not required for this, may be distributed to shareholders.

Smoothing

The claim payout under a with-profits policy aims to dampen the volatility of return from the underlying assets.

Solvency Risk Appetite

The Solvency Risk Appetite describes the Company's approach to the management of its capital position. The Solvency Risk Appetite is the preferred level of capital in excess of the minimum required by regulations. It provides protection to the Company against the risk of breaching regulatory requirements and restricts the ability of the Company to pay dividends.

Specimen policy

The Company uses specimen policies in its calculations where it is not feasible to use all policy data. A specimen policy may, for example, be a suitable example policy that represents the relevant block of business. It may be a policy that is based on averaging the available policy data for the block of business. Alternatively, the specimen policies may be a group of actual policies that, in combination, represent a significant proportion of the block of business.

Strategic investment

Investments in companies in which the Sub-Fund or any other Aviva group company, has a strategic connection or interest, other than investments in other Aviva group companies or properties that are used by such companies to undertake their business.

Surrender

The termination of a contract prior to maturity or for a pension policy earlier than its initial selected retirement date.

With-Profits Actuary

The With-Profits Actuary has responsibility for advising the Board in relation to its exercise of discretion as it affects the with-profits policyholders.

With-profits business

This is that part of the business, which includes the issuing of with-profits policies.

With-Profits Committee

A committee set up in line with COBS requirements for PPFM governance arrangements to provide some independent judgment in assessing compliance with the PPFM and addressing conflicting rights and interests of policyholders and, if applicable, shareholders.

With-profits sub-fund

This is a pool of assets held in respect of with-profits business which can back a combination of with-profits and non-profit policies. There are a number of with-profits sub-funds within the Company, of which the Provident Mutual Sub-Fund is one.

Working capital

An amount representing the fair market value of the with-profits assets less the realistic value of liabilities of a with-profits sub-fund. This is also known as the inherited estate of a with-profits sub-fund.

Appendix B: Background

Company Information

Aviva Life & Pensions UK Limited is an authorised life insurance company incorporated in England. Its registered office and head office are in York, where many of the main business divisions are also centred. It contains policies originally issued by a number of other life insurance companies, whose history is briefly described below.

Norwich Union, Provident Mutual, Commercial Union and General Accident

Norwich Union was founded as a mutual company, owned by its with-profits policyholders, as Norwich Union Life Insurance Society in Norwich in 1808. On 15 June 1997 the company 'demutualised' to form Norwich Union Life & Pensions Limited (NULAP), a company owned by shareholders.

Provident Mutual was founded in 1840 as a Friendly Society, converting to a mutual company in 1874. Commercial Union (CU) was formed as a proprietary company in 1861 in London, England, and CU Life Assurance Company was the company for life business. General Accident (GA) was formed as a proprietary company in 1885 in Perth, Scotland.

In 1995 Provident Mutual demutualised and merged with GA, and Provident Mutual closed to new business. The with-profits business of Provident Mutual was maintained as a separate sub-fund of GA.

In 1998, CU and GA merged to form CGU plc, and GA Life Assurance Limited changed its name to CGU Life Assurance Limited. From October 1998, new with-profits business was written by CGU Life Assurance Limited.

On 30 May 2000, Norwich Union plc (which owned NULAP) merged with CGU plc, to form CGNU plc. CGU Life Assurance Limited changed its name to CGNU Life Assurance Limited. The combined company continued to trade under the Norwich Union brand until June 2009, when it started to trade under the Aviva brand. NULAP then changed its name on 1 June 2009 and became Aviva Life & Pensions UK Limited. However, new with-profits business continued to be written by CGNU Life Assurance Limited throughout this period.

On 1 October 2009, policies in CGNU Life, CU Life Assurance Company and Norwich Union Life (RBS) Ltd were transferred to two new sub-funds in Aviva Life & Pensions UK Limited, the Old With-Profits Sub-Fund and the New With-Profits Sub-Fund. The company also had two further with-profits sub-funds, the NULAP With-Profits Sub-Fund containing the original NULAP business (now known as the With-Profits Sub-Fund), and the Provident Mutual Sub-Fund containing business previous transferred in from Provident Mutual.

Stakeholder pensions business has been written in a separate with-profits sub-fund (the Stakeholder With-Profits Sub-Fund), firstly in CGNU Life and, since October 2009, in Aviva Life & Pensions UK Limited.

On 1 January 2015, the business of Aviva Life & Pensions Ireland Limited was moved into Aviva Life & Pensions UK Limited.

Friends Life companies

On 13 April 2015, Aviva plc bought the Friends Life group, including Friends Life Limited (FLL) and Friends Life and Pensions Limited (FLP). FLL, previously called Friends Provident Life and Pensions Limited, was established on 9 July 2001 and took over the business of Friends Provident Life Office (FPLO) – a mutual company. FPLO had previously taken over the business of the United Kingdom Provident Institution and the London and Manchester Assurance group.

On 1 December 2011, the business of Friends Provident Life Assurance Limited, formerly NM Life Assurance Limited, was moved into FLL. On 28 December 2012, most of the business of Friends Life Company Limited (FLC) (which included policies issued by AXA Equity & Law Life Assurance Society) and Friends Life Assurance Society, formerly Sun Life Assurance Society, was moved into FLL. Then on 28 December 2013, most of the business of Friends Life WL Limited (FLWL), formerly Winterthur Life UK Limited, was moved into FLL. The remainder of the business of FLWL and FLC was moved into FLP.

Following the purchase of the Friends Life companies by Aviva, all the business of Friends Life Limited, and Friends Life and Pensions Limited was moved into Aviva Life & Pensions UK Limited with effect from 1 October 2017, as part of the Scheme.

Fund structure of Aviva Life & Pensions UK Limited

The diagram in Appendix C below shows the current fund structure within Aviva Life & Pensions UK Limited.

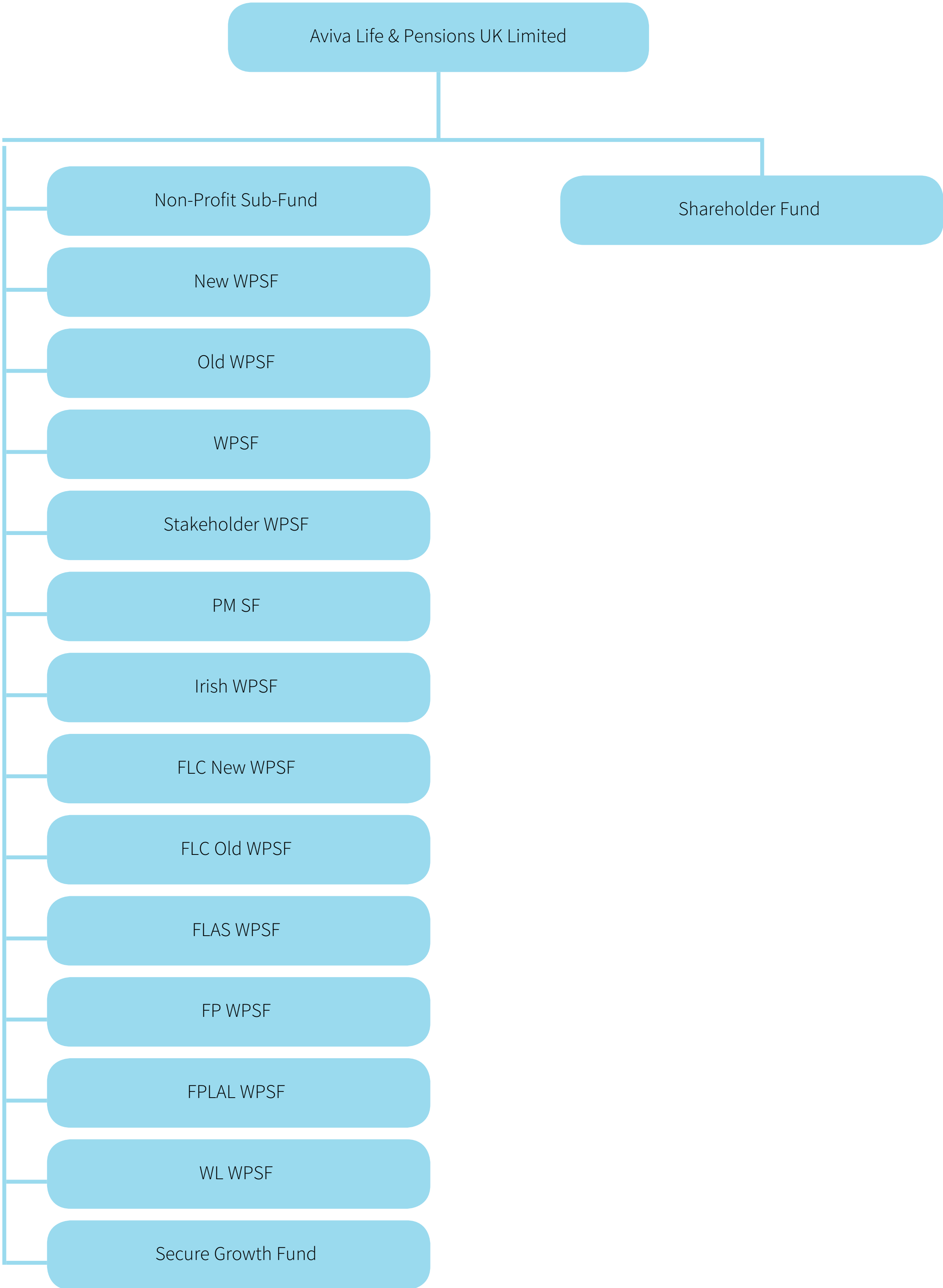
The mergers and transfers outlined above along with other historic mergers and acquisitions involving these companies have resulted in policies sold by a wide range of companies now being in the Company's with-profits sub-funds. The table in Appendix D shows the names of the current with-profits sub-funds together with the original company names under which the policies may have been issued.

Sub-Fund Background: Provident Mutual Sub-Fund

The Provident Mutual Sub-Fund ('PMSF') (the Sub-Fund) is a separate sub-fund of Aviva Life & Pensions UK Limited. The Sub-Fund was set up on 1 January 2005 to receive the long-term business of the former Provident Mutual Life Assurance Association, previously held with the Provident Mutual ('PM') sub-fund of Norwich Union Linked Life Assurance Limited ('NULLA').

This PPFM covers all with-profits business in the Provident Mutual Sub-Fund of Aviva Life & Pensions UK Limited. All of this business relates to policies originally written by Provident Mutual Life Assurance Association prior to its demutualisation in 1996, and increments to those policies or new business written under options on these policies since then. From 1 July 2005, some Provident Mutual with-profits policyholders, who were offered and accepted, have received the CGNU Life investment return in calculating the asset share for their policies from that date. This has been achieved through a reassurance agreement with CGNU Life prior to 1 October 2009 and with Aviva Life & Pensions UK Limited Old & New With-Profits Sub-Funds thereafter. The policies are still covered by this PPFM.

Appendix C: Aviva Life & Pensions UK Limited – Fund structure chart



Note that there are also two further sub-funds, the Belgian Sub-Fund and With-Profits Sub-Fund 5, whose business is wholly reinsured outside the Aviva group.

Appendix D: Original issuing companies

This table shows the current name of each of the with-profits sub-funds, and the possible names of the companies that originally wrote the policies.

Company policy taken out with	Current Aviva Life & Pensions UK Limited With-Profits Sub-Fund
Friends Life Company Limited AXA Sun Life plc AXA Equity and Law Life Assurance Society	FLC With-Profits Sub-Fund(s)
Friends Life Assurance Society Limited Sun Life Assurance Society plc	FLAS With-Profits Sub-Fund
Friends Life Limited Friends Life and Pensions Limited – excluding Secure Growth Fund policies Friends Provident Life and Pensions Limited Friends Provident Pensions Limited – excluding Secure Growth Fund policies Friends' Provident Life Office United Kingdom Temperance and General Provident Institution London and Manchester Assurance Company Limited NM Life Assurance Limited – unitised policies Friends Provident Life Assurance Limited – unitised policies	FP With-Profits Sub-Fund
Dominion-Lincoln Assurance Limited The National Mutual Life Assurance Association of Australasia Limited NM Life Assurance Limited – conventional policies NM Schroder Life Assurance Limited Schroder Life Assurance Limited The Lincoln Life Assurance Company Limited FP Life Assurance Limited Friends Provident Life Assurance Limited – conventional policies	FPLAL With-Profits Sub-Fund
Norwich Union Ireland Norwich Union Insurance Ireland Limited Hibernian Life Limited Hibernian Life & Pensions Limited Aviva Life & Pensions Ireland Limited	Irish With-Profits Sub-Fund

Company policy taken out with	Current Aviva Life & Pensions UK Limited With-Profits Sub-Fund
General Accident Life Assurance Limited Yorkshire-General Life Assurance Company Limited The General Life Assurance Company Yorkshire Insurance Company Limited Scottish Insurance Corporation Limited N&P Life Assurance Limited Commercial Union Life Assurance Company North British and Mercantile Insurance Company Limited London and Scottish Corporation Limited CGU Life Assurance Limited CGNU Life Assurance Limited – except stakeholder plans Norwich Union Life (RBS) Ltd – except stakeholder plans Aviva Life & Pensions UK Limited – except annuity business and stakeholder plans	New and Old With-Profits Sub-Funds
The Provident Clerks' Mutual Life Assurance Association Provident Clerks' and General Mutual Life Assurance Association Provident Mutual Life Assurance Association	Provident Mutual Sub-Fund
Welfare Insurance Company Limited London and Manchester Pensions Limited Friends Provident Corporate (Pensions) Limited Friends Provident Pensions Limited – Secure Growth Fund policies Friends Life and Pensions Limited – Secure Growth Fund policies	Secure Growth Fund
CGNU Life Assurance Limited – stakeholder plans Norwich Union Life (RBS) Ltd – stakeholder plans Aviva Life & Pensions UK Limited – stakeholder plans	Stakeholder With-Profits Sub-Fund
Norwich Union Life Insurance Society Norwich Union Life & Pensions Limited Aviva Life & Pensions UK Limited – annuity business	With-Profits Sub-Fund
National Westminster Life Assurance Limited Royal Scottish Assurance plc	With-Profits Sub-Fund 5
The Colonial Mutual Life Assurance Society Limited Colonial Mutual Life (Unit Assurances) Limited Colonial Life (UK) Limited Friends Life WL Limited Winterthur Life UK Limited Provident Life Association Limited	WL With-Profits Sub-Fund

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