

Report to with-profits policyholders by the Board of National Provident Life Limited for the period 1 January 2010 to 31 December 2010

Purpose

The Principles and Practices of Financial Management (“PPFM”) for National Provident Life Limited (“the firm”) is a detailed document which sets out how National Provident Life Limited manages its with-profits business. During 2010, you should have received an updated version of “A Guide to How We Manage Our With-Profits Fund” which explains the main features of the PPFM. It is available on request, and on our website (see below).

The firm has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of this report is to describe how the firm has complied with its PPFM in the period covered by the report and to set out the firm’s reasons for that belief. In particular, the report covers the way in which the firm has exercised, or failed to exercise, any discretion that it has in the conduct of its with-profits business and how it has addressed any competing or conflicting rights, interests or expectations of its policyholders and shareholders.

A Scheme to transfer the firm’s SERP business to Pearl Assurance (the “SERP transfer Scheme”) became operative on 15 February 2010 with an effective date of 4 January 2010. Although the SERP transfer Scheme did not become effective until 2010, its impact on policyholders was considered in the report to with-profits policyholders for the period 1 January 2009 to 21 December 2009 and is, therefore, not considered in this report.

Independent review

As part of the demutualisation of National Provident Institution, the National Provident Life Fund Supervisory Board was established to be responsible for, amongst other things, the investment and bonus policy of National Provident Life Limited, and to protect policyholders’ interests. A majority of the members of the Supervisory Board are independent of the shareholder. The Supervisory Board also sits in the capacity of the National Provident Life Fund With-Profits Committee to review how the With-Profits business is managed. The With-Profits Committee met eight times in 2010.

While this report has not been subject to external independent review, the With-Profits Committee has seen and approved it.

Summary

Payouts for with-profits policies depend on the discretion exercised by the firm. The interests of with-profits policyholders are protected by the PPFM and a High Court Scheme of Transfer at the time of the demutualisation of National Provident Institution (the “Scheme of Transfer”), which sets out a number of provisions the firm must abide by.

Each year the Board will produce a report to you, the with-profits policyholders, summarising compliance with the PPFM and how any discretion has been used over the previous year.

The PPFM covers the following areas:

- Methods used to determine payouts
- Setting annual bonus rates
- The approach to setting final bonus rates
- Smoothing of payouts
- Investment strategy
- Business risks
- Charges and expenses
- The estate
- Use of the Scheme Capital Account
- New business
- Equity between policyholders and shareholders
- Portfolio Bond

Each of these is expanded on in the sections below. In addition there is commentary on changes to the PPFM and communications with policyholders during the year.

Methods used to determine payouts

Asset shares remain the basis for payouts on with-profits policies, subject to a minimum payout of any guaranteed benefits, as set out within the PPFM.

The financial position of the with-profits fund on a realistic basis remained weak during 2010 and the decision was taken to deduct 2% from asset shares used in determining payouts from 31 December 2010. Similar deductions were also made in September 2007, October 2008 and October 2009.

In the Board's opinion, the methodology used to calculate asset shares and the above action has been in line with the PPFM. Further, in the Board's opinion, the discretion applied to the methods used to determine payouts on all policies during 2010 has been in line with the PPFM.

The intention is to pay you an amount close to your asset share, subject to any guaranteed benefits, when the policy pays out. This was achieved during 2010 by the way the final bonuses were set, by adjusting surrender value calculations and the way the market value reductions ("MVRs") were set for unitised with-profits and Capital Account business. The Board is satisfied that the approach taken in determining final bonuses and MVRs during the year was in line with the PPFM.

Setting annual bonus rates

Bonuses are the additions which the firm makes to the value of your policy.

As previously advised, most annual bonus rates are set to zero, and are likely to remain so. The Board is satisfied that the approach taken in determining annual bonuses during the year was in line with the PPFM.

The approach to setting final bonuses

Final bonus rates and MVRs were changed at the start of 2010 for most business and the MVRs for Capital Account were also reduced from 30 June 2010. The final bonuses and MVRs for Portfolio Bond were changed four times during 2010; at the start of the year and at the end of each quarter. The changes reflected movements in asset share subject to smoothing. The Board is satisfied the changes resulted in changes to payouts that are consistent with the PPFM and consistent with treating customers fairly.

Smoothing of payouts

There were no changes to the way the ups and downs of investment markets were reflected in policy values during the year.

Investment strategy

There were no significant changes to investment strategy during 2010, but the fund intends to replace its property assets by other more readily saleable equity-type assets, subject to investment considerations with regard to timing.

Business risks

There were no significant changes to the risks the fund was exposed to during the year.

Charges and expenses

The way charges and expenses were set was unchanged during the year and in line with the Scheme of Transfer. The Board is satisfied that the allocation of expenses and the charges deducted were in line with the PPFM.

The estate

The estate remains minimal, and will continue to be used to meet, as far as it can, the costs where guaranteed payouts to policyholders exceed asset share. There remains no prospect of any estate distribution to policyholders. The Board is satisfied that the approach to the management of the estate is in line with the PPFM.

Use of the Scheme Capital Account

The Board is satisfied that the management of the Scheme Capital Account has been in line with the PPFM.

Part of the Scheme Capital Account was transferred to Pearl at the start of 2010 in accordance with the SERP transfer Scheme.

New business

The type of new business written was unchanged during the year and the Board is satisfied that this is in line with the PPFM.

Equity between policyholders and shareholders

Payments to shareholders were not greater than those required under the Scheme of Transfer and the Board is satisfied that any payments made were in line with the PPFM.

Portfolio Bond

Portfolio Bond was written in the second half of 1999 and the with-profits element of these policies is wholly reassured to Pearl Assurance Limited. Consequently much of the discretion surrounding these policies rests with Pearl Assurance Limited, and it is the sections relating to reassured business in its PPFM that are most relevant to Portfolio Bond with-profits policyholders.

Portfolio Bond policyholders may also wish to read the report of the Pearl Board to policyholders.

Changes to the PPFM

There have been two versions of the National Provident Life Limited PPFM and one version of the Pearl Assurance Limited PPFM in force during the year. Changes to the National Provident Life Limited PPFM were made as a consequence of the SERP transfer scheme, including the addition of a new principle. Policyholders were notified in advance of this new principle in 2009.

The changes to the PPFM were

- an additional principle permitting different investment returns to be used for determining asset shares for different groups of with-profits policyholders, subject to certain safeguards;
- changes to the ranges in which payouts for Profit Sharing Account and Conventional With-Profits business are expected to fall;
- changes to exclude references to SERP; and
- minor wording improvements.

Communications to policyholders

During 2010 policyholders, should have received their annual policy statements and the accompanying letter.

Policyholders also received a revised version of "A guide to how we manage our with-profits fund".

Policyholders will be notified of the changes in the PPFM practices referred to above in their 2011 annual statements.

The NPI website (www.npi.co.uk) contains a number of additional documents relevant to policyholders, including the current versions of the National Provident Life Limited PPFM and the Guide to How We Manage the With-Profits Fund referred to in the opening paragraph of this report. The current versions are those effective from 1 March 2010 and reflect the changes made as part of the SERP transfer Scheme.

Conclusion

The Board believes that National Provident Life Limited has acted in accordance with its Principles and Practices set out in the PPFM, and that Pearl Assurance Limited has likewise complied with the parts of its PPFM relevant to Portfolio Bond with-profits policyholders. We are satisfied that the way both companies have exercised their discretion during the year with respect to National Provident Life Limited with-profits policyholders was fair and reasonable.

The directors of National Provident Life Limited

June 2011

Report to with-profits policyholders by the With-Profits Actuary of National Provident Life Limited for the period 1 January 2010 to 31 December 2010

Purpose

The Principles and Practices of Financial Management (“PPFM”) for National Provident Life Limited (“the firm”) is a detailed document which sets out how the firm manages its with-profits business.

The firm has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of my report to the firm’s with-profits policyholders is to give my opinion, as required by the rules of the Financial Services Authority, as to whether the firm has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2010.

Conclusion

In my opinion the firm has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2010.

My opinion is based on the information which the firm has provided to me during the year on the management of its with-profits business and on investigations I have undertaken.

The Board for Actuarial Standards has recently published a number of Technical Actuarial Standards (“TASs”). This report is intended to comply with TAS R (which relates to the reporting of actuarial information) TAS M (which relates to modelling) and TAS D (which relates to data), the latter on the grounds that non-compliance with the documentation requirements is not material to the recommendations contained in this report.

David Addison BSc FFA

With-Profits Actuary of National Provident Life Limited

June 2011