

A Guide to How We Manage the Pearl SERP Fund

Aims of this guide

This guide is a summary of how we manage the Pearl SERP Fund.

Why this guide is important

You have a Self Employed Retirement Plan (SERP) originally taken out with NPI. As a result of a transfer of business, your money is now invested in the Pearl SERP Fund. This guide is a summary of how we manage that fund and how this affects your policy.

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

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1. Background

Self Employed Retirement Plans (SERPs) were originally issued by National Provident Institution (NPI). All the existing business of NPI was taken over by National Provident Life Ltd on 1 January 2000 following the demutualisation of NPI.

As a result of a transfer of business approved by the High Court on 5 February 2010, these contracts were transferred to Pearl Assurance Limited (Pearl). Pearl consequently established the Pearl SERP Fund which is separate from Pearl's main with-profits fund.

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

What is the PPFM?

The PPFM explains in detail how we manage the Pearl SERP Fund. The PPFM is quite a long, detailed and complex document so this guide is designed to explain the most important points to you as simply as we can. If you want to see the full PPFM

for the Pearl SERP Fund you can get a copy from our website (www.pearl.co.uk) or by writing to us.

What are the Principles of Financial Management?

The principles are the basis by which we manage the Pearl SERP Fund. These are high level statements that describe our long term approach. We don't expect to change the principles often.

The key drivers of the principles are:

- We aim to treat all customers fairly.
- We will manage our business in a lawful and financially sound manner.
- We aim to manage the Pearl SERP Fund so we can pay all guaranteed benefits.

We do not intend to change our approach to managing the Pearl SERP Fund. However, there are some circumstances when we might need to do so, for example, to:

- Protect the financial position of the fund in adverse circumstances;
- Ensure we comply with any changes in taxation or regulatory requirements; or
- Deal with unforeseen events that have a significant impact on the fund.

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

What are the Practices of Financial Management?

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

We will inform you in writing at the next available opportunity of any material changes.

Governance arrangements

The responsibility for the management of the Pearl SERP Fund rests with the Board of Pearl Assurance Limited.

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

The with-profits committee consists mainly of independent members.

Each year starting in 2011 an annual report will be produced for policyholders of the Pearl SERP Fund stating whether, throughout the previous year, we believe we have complied with our obligations relating to the PPFM. Attached to that report will be a separate report from the with-profits actuary. You will be able to obtain a copy from our website (www.pearl.co.uk) or by writing to us.

3. What is a SERP?

The Self Employed Retirement Plan (SERP) is a type of pension savings policy.

(The term SERP is also used to cover similar older contracts known as Deferred Annuities for the Self Employed).

These policies were designed to build up a guaranteed level of annual pension income – typically payable annually in arrears.

Over the years, annual bonuses have been added to these policies in the form of further guaranteed pension amounts.

You will normally have the option to take the pension benefits anytime after age 60 but they must be taken before age 75. Under current legislation, you do not have to retire to take the benefits i.e. you can start taking the benefits but continue working.

When you come to take the benefits, as an alternative to taking the guaranteed annual pension you will be able to exchange it for a capital sum (a pension fund). This pension fund can be used to buy either a pension (annuity) from us, payable in a different way to that guaranteed in your policy (e.g. monthly in advance, as opposed to annually in arrears), or to buy a pension from another provider – this is known as the Open Market Option (OMO).

You will also have the option to exchange part of your pension for a tax free lump sum.

4. The Pearl SERP Fund and how we invest it

The Pearl SERP Fund is managed as a separate fund within the Pearl long term fund. The investment strategy for the Pearl SERP Fund will be consistent with sound financial management, with the aim of ensuring there are sufficient funds to meet all claims as they fall due.

The Board will approve the proportion of the SERP fund that is to be invested in different types of assets and the restrictions that apply.

The fund will be mainly invested in fixed interest investments. This is consistent with the approach adopted by National Provident Life Ltd since 2003.

As a result of the significant falls in the stock market from 2000 through to 2003, National Provident Life Ltd sold almost all of its equity investments in order to safeguard their ability to pay the guaranteed amounts promised on policies. Since that time, the fund has mostly invested in fixed interest investments.

With effect from 15 February 2010 the relevant assets were transferred to the Pearl SERP Fund.

The SERP fund may use 'derivatives' (for example, the right to buy or sell securities at a pre-agreed price on a specific date) as an efficient way of quickly changing the investments in the fund and/or to reduce risks.

The investment return credited to the asset shares (before allowing for expenses and charges) will reflect the actual returns earned on the underlying assets. This is consistent with the approach previously adopted by National Provident Life Ltd.

What is an 'asset share'?

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

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

Asset share =

- the total of all the premiums you have paid
plus
- the investment returns
minus
- expenses and charges made to your policy (including an allowance for any death benefits)

In most cases, it is impractical to calculate the asset share for every individual policy in a fund. We therefore calculate the asset share by looking at a range of sample policies rather than individual policies.

5. How is the value of my SERP calculated?

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

- Your age.
- The number and amount of the premiums you have paid.
- The investment performance of the assets bought by the fund over the years (see section 4).
- The level of any guaranteed benefits (see section 8).
- The extent to which smoothing is applied (see section 7).
- The charges and/or expenses deducted from your policy (see section 9).

When you make a claim against your policy, we compare the value of the policy's 'asset share' with the value of any guaranteed benefits. We aim to pay you whichever value is higher.

It is our objective that payouts to policyholders should, on average, be targeting their asset share (see section 4), except where the guaranteed benefits are higher.

For example, the transfer value will generally be based on your asset share, but after age 60 the value will be calculated allowing for any guarantees that apply. This means that in many cases the transfer value payable at age 60 and above will be noticeably higher than that payable before age 60.

6. Regular (annual) bonuses

When considering whether to add further regular bonuses we look at a number of factors including:

- The performance of the fund – both short term and long term.
- The current financial position of the fund and how this is likely to change in the future.
- The level of guaranteed benefits compared to the asset shares.

In many cases, the value of the guaranteed pension now significantly exceeds the underlying asset share. For this reason, no regular (annual) bonuses have been added over recent years.

This is expected to remain the position and we do not expect to declare an annual bonus in the foreseeable future.

7. Final bonus and smoothing

To make up any shortfall between guaranteed benefits and the actual performance of the fund, a final bonus may be added to the guaranteed benefits when you make a claim on your policy.

Final bonuses are set with the aim that, on average, the total policy payout targets asset share (see section 4). Final bonuses are typically reviewed every six months, but can be changed more frequently if economic conditions change significantly.

Final bonuses are not guaranteed and may be small or nothing depending on the performance of the Pearl SERP Fund.

In order to avoid excessive differences in payouts on similar policies over short periods of time, to a limited degree we hold back some of the performance in the better years to use when returns are poor. This is known as smoothing.

In many cases, the benefits available at retirement at age 60 or above will be the amount of the existing guaranteed pension benefits.

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

If you end your policy at a date when the guarantees don't apply, for example by transferring your accumulated pension fund to another pension provider, we work out how much to pay you bearing in mind that we must be fair to all policyholders, those who stay, as well as those leaving. On average, we aim to pay each policyholder their asset share.

9. Guarantees and why they are important

When these policies were first issued, in general, guarantees were set assuming a lower level of investment return than NPI expected to earn on the fund. This allowed them some flexibility to invest in assets which were expected to offer a better long term return but whose values could fluctuate in the short term. The aim was to pay out values reflecting actual returns.

Once an annual bonus had been added, it increased the guaranteed amount payable on the policy and cannot be taken away.

Since 2000, investment returns have been poor (see section 4) and, as a result, asset share values have reduced. At the same time, people have been living longer, meaning that the value of guaranteed pensions has increased. However, you are

protected and will, as a minimum, receive your guaranteed pension when you take benefits at age 60 or later.

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

10. Charges and expenses

Expenses include any commission payable, the costs of administering the policies, managing the fund and the costs of smoothing (see section 7).

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

All charges for administration and expenses are based on the scale of charges set out in the High Court Scheme governing the transfer of SERPs to Pearl Assurance Limited – increased by 1% above the rate of inflation each year. The cost of investment management is also based on the scale of charges established by the High Court Scheme. The High Court Scheme also provides a cap such that these charges cannot exceed those that would be payable had the policies remained in National Provident Life Ltd.

11. How we manage exposure to risk

Pension funds are exposed to a number of risks as a result of product design, for example providing guarantees to policyholders, selling and marketing practices, interest rate and market fluctuations and how long people are expected to live.

The Pearl SERP Fund is closed to new business and is run as a separate fund within Pearl's overall funds. It will be managed in such a way as to minimise existing risks in order to safeguard our ability to pay the guaranteed amounts promised on policies.

Policyholders are still exposed to the risk of changes in future interest rates and changes in mortality (how long people live) which will impact the amounts that can be taken as a tax free lump sum or as an Open Market Option value (see section 3).

12. What is the 'estate'?

Some life companies have what is known as an inherited 'estate'. This is money, or surplus, built up over the years, which is in excess of the asset share and which provides working capital for the fund and supports the operation of the fund. There is no inherited estate in the Pearl SERP Fund.

The working capital for the Pearl SERP Fund (the Pearl SERP Fund estate) is required to meet the expected costs of guaranteed benefits, over and above asset shares. Part of this support is potentially payable to policyholders to the extent that it is not needed to meet the costs of guaranteed benefits. However, given the significant costs of the guaranteed benefits, no such payment is expected.

SERP policyholders have no rights to share in this estate (other than to meet any guaranteed benefit costs), nor are they entitled to share in any distribution of any other Pearl estate.

13. Fairness between policyholders and shareholders

As described in section 5, when you take the benefits we will compare the asset share with any guaranteed benefits that apply and pay the higher amount.

If the guaranteed benefits are higher than the relevant asset share, the amount of the excess will be met from the Pearl SERP Fund estate (provided by Pearl's shareholders).

14. How to find out more

You can get a more detailed technical description of how we manage the Pearl SERP Fund in the PPFM. You or your adviser can obtain a copy from our website (www.pearl.co.uk), or by writing to us.

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

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

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

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