

**ANNUAL REPORT**  
**by the**  
**BOARD**  
**of**  
**PEARL ASSURANCE PLC**  
**to its**  
**WITH-PROFITS POLICYHOLDERS**  
**on compliance with the**  
**PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT**  
**for the year ended 31<sup>st</sup> December 2009**

## **Purpose**

The Principles and Practices of Financial Management (PPFM) for Pearl Assurance PLC (Pearl) is a detailed document that sets out how Pearl manages its with-profits business.

You will have been sent 'A Guide to How We Manage Our With-Profits Fund', explaining the main points of the PPFM.

The purpose of this report is to describe how Pearl has complied with its PPFM in the period covered by the report. In particular, it deals with how Pearl has exercised its discretion in areas such as setting annual bonuses, policy payouts and surrender values, and how it has addressed any competing or conflicting rights of policyholders and shareholders.

## **Independent Review**

A With-Profits Committee (WPC) was formed in 2004 to review how the with-profits business is managed. The WPC is responsible for overseeing that the management of with-profits business is consistent with the PPFM. The WPC provides independent verification that processes followed and decisions taken are consistent with the PPFM. The WPC has seen and supports this report.

## **Summary**

Insurance policies sold by Pearl are classified as either 'with-profits' or 'non profit' policies. Payouts for with-profits policies depend on the discretion exercised by Pearl, and therefore the interests of customers with these policies are protected by the requirement to treat customers fairly as described in the PPFM.

The With-Profits Actuary has a legal duty to advise Pearl on the way it exercises its discretion over with-profits policies. Each year Pearl has to produce a report such as this to the with-profits policyholders, summarising how this discretion has been used over the previous year.

Overall, we are able to say that Pearl has complied with the PPFM in its exercise of discretion over with-profits policies.

The main areas of discretion are as follows. Each of these is expanded on in the sections below:

- Amounts Payable
- Investment strategy
- Business Risk
- Charges and Expenses
- Management of Estate
- New Business
- Equity between the with-profits fund and Shareholders
- Changes to the PPFM
- Communications to Policyholders

## **Amounts Payable**

### **Bonus Rates**

Bonuses are the additions that Pearl makes to the value of your policy. They come in the form of annual bonuses (that are added each year) and final bonuses (that are added when the policy pays out). Pearl sets bonus rates by reference to asset shares. The general aim is to pay the asset share.

### **Asset Shares**

Asset shares are intended to be a reasonable approximation of the contribution a policy has made to the with-profits fund. Calculation of asset shares in 2009 followed the methodology set out in the PPFM.

### **Annual Bonus Rates**

As in 2008, no annual bonuses were added to conventional or personal pension version 1 policies at 31 December 2009. Personal pension version 1 policies are managed on a unitised basis (effective 1 January 2008). For other unitised policies annual bonuses are added in daily steps and the daily rates for adding annual bonuses were reviewed regularly during 2009. These bonus rates comply with the PPFM. The annual bonuses were set with the view that a proportion of the final payout comprises a final bonus.

### **Final Bonus Rates**

Final bonus rates for conventional policies were reviewed twice for the 2009 calendar year with new final bonus scales being implemented from 1 January and 1 July. The final bonus rates were calculated using the methodology set out in the PPFM.

Final bonus rates and Market Value Reduction Factors ("MVRFs") on unitised policies (other than personal pension version 1) were reviewed at least monthly during 2009. The rates were calculated in accordance with the PPFM.

With effect from 1 January 2008 personal pension version 1 policies have been managed so that policy values better reflect the underlying asset mix in the with profits fund and payouts more closely target asset shares in accordance with the PPFM. No final bonus scale is now needed but each payout includes an individual final bonus reflecting that policy's asset share.

### **Payout Ranges**

The PPFM sets out a target range that 90% of payouts should fall within 80% to 120% of asset share. During 2009 only 87.4% of actual claims fell within this range. This was caused by a number of factors including the fact that claim payments for conventional with profits policies were significantly above asset shares in 2009 due to the smoothing rules in the PPFM which limit the fall in payouts from one year to the next.

## **Investment Strategy**

Pearl holds assets that it uses to make payments when policies pay out. Pearl needs to invest these assets sensibly, so that it can afford to make payouts when they are due, but also must aim to earn investment return on these assets so that bonuses can be paid.

From 1 January 2007, Pearl has decided to increase the target for the Equity Backing Ratio to 50% for certain classes of life with-profits policies (please refer to the

PPFM). The increased exposure to shares and property gives the prospect of higher long-term investment returns. In the short term the investment returns may be higher or lower.

Over the long term, the higher Equity Backing Ratio (EBR) is intended to provide better investment growth although this cannot be guaranteed.

Pearl will keep this policy under review.

The exact level of the EBR will move with investment conditions. The aim is to maintain it within a range approximately 5% either side of the 50% target. The EBR was maintained within this range throughout 2009.

The with-profits fund undertakes stock-lending activities. These activities generated losses in 2008 which have been partially reversed in 2009. These losses have not, to date, been borne by policyholder asset shares. There was an impact on the amount of Pearl's estate distributed in 2009 due to the effect of these losses in the estate.

### **Business Risk**

During 2009 Pearl did not take on any significant risks that would be likely to jeopardise the interests of with-profits policyholders.

### **Charges and Expenses**

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

At the end of 2008 the with-profits fund set aside a provision for potential group pension scheme contributions and a contribution was made in 2009. To date, the provision and contribution have been charged to the estate and not to policyholder asset shares.

### **Management of Estate**

The estate of Pearl Assurance began to be distributed with effect from 1 July 2007. No distributions of the estate were made as at 1 July 2009 and 31 December 2009 due to the financial condition of the fund. These nil distributions were in accordance with the PPFM.

### **New Business**

During 2009 Pearl did not sell new with-profits business.

### **Equity between Policyholders and Shareholders**

There was no change to the method used to split profit between with-profits policyholders and shareholders during 2009.

### **Changes to the PPFM**

There were no changes to the PPFM during 2009.

### **Communications to Policyholders**

A 'customer friendly' version of the PPFM has been sent to with-profits policyholders, in addition to the usual annual policy statements and other communications to specific groups of policyholders. A copy was available on Pearl's website throughout 2009.

### **Conclusion**

The Board of Pearl Assurance PLC believes that it has complied with the obligations relating to the PPFM.

**Pearl Assurance PLC**

**5 May 2010**

**With-Profits Actuary of Pearl Assurance PLC**  
**Annual Report to With-Profits Policyholders**  
**for the year ended 31<sup>st</sup> December 2009**

**Purpose**

The Principles and Practices of Financial Management (PPFM) for Pearl Assurance PLC (Pearl Assurance) is a set of rules that governs how Pearl Assurance exercises discretion in relation to its with-profits policyholders.

Pearl Assurance has discretion in a number of areas, such as setting annual 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 give my opinion as to whether Pearl Assurance has taken the interests of with-profits policyholders into account in a 'reasonable and proportionate' manner in exercising this discretion during 2009.

The Board for Actuarial Standards has issued a standard (TAS R) which applies to reports produced by actuaries. My report is intended to comply with TAS R except that, in terms of completeness, I have not considered it necessary or desirable to repeat or elaborate on material that is covered by the firm's own report to which my report is annexed

**Conclusion**

I consider that during 2009 Pearl Assurance has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner.

My opinion is based on the information provided by Pearl Assurance during the year.

**Kevin Arnott**

**With-Profits Actuary**

**5 May 2010**