

**Zurich Assurance Ltd**

Principles and Practices of Financial Management –  
2010 Annual Compliance Report to 100:0 With-Profits Fund  
Policyholders

23 June 2011

---

# Table of Contents

1.	INTRODUCTION .....	1
2.	WITH-PROFITS GOVERNANCE.....	3
3.	BONUS RATES .....	4
4.	INVESTMENT STRATEGY.....	5
5.	SURRENDER VALUES .....	6
6.	EXPENSES AND CHARGES .....	7
7.	CHANGES TO PPFM.....	8
8.	COMMUNICATION WITH POLICYHOLDERS .....	9
9.	COMPETING OR CONFLICTING RIGHTS, INTERESTS OR EXPECTATIONS	10
	APPENDIX – WITH-PROFITS ACTUARY’S REPORT TO POLICYHOLDERS.....	11

## 1. INTRODUCTION

Zurich Assurance Ltd (ZA) first published its Principles and Practices of Financial Management (PPFM) on 30 April 2004. The PPFM describes how we manage the with-profits business in the 100:0 Fund originally written when ZA was called Eagle Star Life Assurance Company Limited.

The PPFM plays an important role in the governance of with-profits business and ensuring that customers are treated fairly. We made no changes to the PPFM during 2010.

This report covers how we complied with the PPFMs which applied during 2010. You can view the current PPFM on our website at **[www.zurich.co.uk/withprofits](http://www.zurich.co.uk/withprofits)**

The fund is effectively closed to new with-profits business. However, it still accepts small amounts of new with-profits business from contractual increases, switches and other options which it is obliged to accept under the terms of existing policies.

ZA has to tell its with-profits policyholders every year whether it has complied with its obligations in the PPFM. This report covers the period 1 January 2010 to 31 December 2010 inclusive.

It is the opinion of the ZA Board of Directors that during 2010:

- the company has complied with its obligations in the PPFM
- the way it exercised discretion was appropriate
- it has addressed any competing or conflicting rights, interests or expectations of its policyholders and shareholders in a reasonable and proportionate manner.

In particular this concerns the following areas which we describe in this report:

- bonus rates
- investment strategy
- surrender values
- expense incurred and charges made
- changes to the PPFM
- communications with policyholders.

In preparing this report, we sought advice from the With-Profits Actuary (WPA) and the Independent Reviewer. A separate report from the WPA giving his opinion on whether the company has applied its discretion in a reasonable and proportionate manner is attached as an appendix.

When reading this report, you may wish to refer to the PPFM for definitions of technical terms.

## 2. WITH-PROFITS GOVERNANCE

The Board of ZA is responsible for managing the with-profits business including setting bonus rates. You can find a broad description of the Board's governance role in Section 11 of the PPFM. ZA has set up procedures so the Board can satisfy itself regularly that the with-profits business is being managed in line with the PPFM.

Since 31 December 2004 there has been the specific role of With-Profits Actuary, whose responsibilities include advising the Board on the exercise of its powers of discretion in managing the with-profits business. The Board may also call upon advice from other senior managers in the Company with knowledge and experience of the with-profits business. The Board has appointed M Godwin as With-Profits Actuary.

In addition the governance arrangements must involve some independent assessment of compliance with PPFM and how any competing or conflicting rights and interests of policyholders and shareholders have been addressed. The Board has appointed D Lechmere to provide this independent assessment.

### 3. BONUS RATES

We declared bonuses on 18 January 2010. No changes were made to Annual Bonuses in this declaration. These rates applied until the next declaration on 10 January 2011.

We determine Final Bonuses and Market Value Reduction factors (MVRs) on a policy-specific basis to reflect in broad terms the difference between the target level of payouts and the nominal value of with-profits units. During 2010 we set Final Bonuses and MVRs to target an average of 100% of asset share to be paid at maturity. MVRs are not applied on death or maturity. No MVRs have applied to other claim types since 6 September 2010. Appendix B of the PPFM describes the calculation of asset shares. All ZA asset shares are unsmoothed as any smoothing is applied in the calculation of the amount paid.

From 1 January 2009 the Estate (described in section 10.2.1 of the PPFM) is being distributed to customers using the terminal bonus or MVR mechanism by considering whether to include an enhancement within asset shares at the time of claim as described in section 10.2.2 of the PPFM. An enhancement of 5% to asset share at the time of claim was applied to claims in 2010 before 18 January 2010. For all other claims during 2010 this enhancement was increased to 6%. The enhancement may be lower for investments made within five years of the time of claim and ZA reserves the right to exclude any new investment into the fund made after 1 April 2009. The enhancement can be altered or removed entirely at any time, depending on the experience of the fund.

We also target that at least 90% of maturity payments would be within the range 90% to 110% of unsmoothed asset share. During 2010 we met this target. Maturity payments where a guaranteed amount is paid are excluded from this assessment.

The ZA Board was given supporting information to determine that the bonus declaration and smoothing applied in 2010 were consistent with the obligations in the PPFM. The declaration was reviewed and supported by the With-Profits Actuary and the Independent Reviewer.

#### 4. INVESTMENT STRATEGY

During 2010, following a change to ZA committee structures, investment policy for the 100:0 Fund became the responsibility of the Asset/Liability Management Investment Committee (ALMIC). This is a subcommittee of the Board and takes account of advice from the Investment Managers, the Chief Financial Officer, the Head of the Actuarial Function and the With-Profits Actuary. The ALMIC refers any major proposals on investment strategy to the Board for approval. Previously the investment policy for the 100:0 Fund was the responsibility of the Investment Committee which in this respect performed the same function as the ALMIC.

The total investment return of the fund in 2010 was 7.2% before deducting tax and charges. This return was applicable to pensions plans but was reduced for life and savings plans to 6.2% before charges because of the tax we have to pay. This performance, applied to asset shares, reflected good returns from equities (shares).

We continue to make sure the mix of investments is appropriate to protect the benefits already added to plans. The percentage invested in equities remained at around 25% during 2010 and we expect the percentage invested in equities to remain between 22% and 28% for the time being. The rest of the fund is invested in fixed interest and variable rate securities and cash.

The PPFM allows a change to the investment approach for the fund so that we may, if appropriate, invest the fund differently for different groups of policy. For now no changes to the investment strategy have been made but we will keep the mix of assets and share options under review and let policyholders know each year how we have invested the fund for their policy.

During 2010 the fund held a series of derivatives to protect the fund from significant falls in equity values (see section 7.2.8 in the PPFM for details). At the start of the year the fund held a collar which expired in March 2010. As this collar expired the protection it represented was replaced by a further collar expiring in March 2011. During 2010, as the UK equity market rose significantly, the derivatives reduced the return to the fund. The investment return would have been 9.0% before deducting tax and charges if no derivatives had been held.

## 5. SURRENDER VALUES

We determine Final Bonuses and Market Value Reduction factors (MVRs) daily on a policy-specific basis to reflect in broad terms the difference between the target level of payouts and the nominal value of with-profits units. During 2010 we set Final Bonuses and MVRs to target an average of 100% of asset share to be paid on surrender.

From 1 January 2009 an enhancement may be included in asset share at the time of claim to allow distribution of the Estate. An enhancement of 5% to asset share at the time of claim was introduced from 12 January 2009 for most policies and applied to claims in 2010 before 18 January 2010; this enhancement was increased to 6% for all other claims during 2010. This enhancement is described in detail in section 3.

Each day, we apply smoothing to policy benefits to reduce the impact of short-term changes in asset values on surrender values.

We also target that at least 90% of surrender payments are within the range 90% to 110% of unsmoothed asset share. During 2010 we met this target.

## 6. EXPENSES AND CHARGES

For policies in the 100:0 Fund we levy specific charges. We define these charges in the policy conditions and include charges for the costs of administration and risk benefits. These charges have a direct impact on the asset shares of the policies of the 100:0 Fund.

During 2010 we met the costs of certain other guaranteed benefits from the resources in excess of asset shares of the 100:0 Fund. An example of guaranteed benefits is the promise not to apply an MVR on certain guarantee dates.

## 7. CHANGES TO PPFM

We made no changes to the PPFM during 2010.

## 8. COMMUNICATION WITH POLICYHOLDERS

Policyholders have received the following with-profits communications during 2010:

- March 2010            Following the bonus declaration on 18 January, we began the customer mailing in March. This consisted of an annual notice which included details of any bonuses granted to their policy, a leaflet covering investment information and a summary of how we manage the 100:0 fund. We also told policyholders that the PPFM compliance report for the year 2009 would be available by 30 June 2010.
- June 2010            We published the 2009 annual report on compliance with the PPFM on the ZA website. This document consisted of a report to Policyholders from ZA on Compliance with the PPFM and a report to Policyholders from the With-Profits Actuary covering discretion exercised by ZA. These were the 2009 editions of this document.

## 9. COMPETING OR CONFLICTING RIGHTS, INTERESTS OR EXPECTATIONS

### 9.1 FAIRNESS BETWEEN DIFFERENT GROUPS OF POLICYHOLDERS

One of ZA's objectives is to achieve an orderly run-off of the fund over the remaining lifetime of the policies in force. This means that both the assets needed to support current and future liabilities and any other assets within the fund are considered when deciding the level of bonuses, MVRs and the extent of smoothing.

We currently achieve a fair distribution by targeting 100% of asset share on claim for each contract and paying guaranteed values if greater.

### 9.2 FAIRNESS BETWEEN POLICYHOLDERS AND SHAREHOLDERS

Expense allocation, tax and distributions of surplus are normally the main areas where equity between with-profits policyholders and shareholders could potentially be an issue.

Policy conditions set out the charges which we can make for administration.

The PPFM sets out the basis for applying tax to the fund. Tax is applied to the investment returns as if the fund had been a stand-alone business independent of the other business of the Company. We make no allowance for any tax relief available on the expenses incurred by the Company as the expenses are met by other funds.

As policyholders are entitled to 100% of the investment surplus in the 100:0 Fund, there are no costs of shareholder transfers associated with distribution of surplus.

So, in all three areas the potential for conflict is significantly reduced or removed.

We are vigilant in monitoring the accuracy of our systems. If we discover an error we take action to ensure that policyholders are not materially disadvantaged.

## **APPENDIX – WITH-PROFITS ACTUARY’S REPORT**

### **2010 Annual Report from the With-Profits Actuary to 100:0 Fund Policyholders**

It is my opinion, in my capacity as With-Profits Actuary of Zurich Assurance Ltd (ZA), that the annual report from ZA – contained above – and the discretion exercised by ZA during 2010 have taken the interests of the different categories of with-profits policyholders into account in a reasonable and proportionate manner.

I have formed this opinion based on the information and explanations given to me by ZA, and taking into account the relevant rules and guidance in the Financial Services Authority’s Conduct of Business Sourcebook Chapter 20 (With-Profits) and Supervision Manual Rule SUP 4.3.16AR (With-Profits Actuary’s duty to provide With-Profits Policyholders with an annual written report).

The Board for Actuarial Standards has issued new standards known as Technical Actuarial Standards applying to reports produced by actuaries. Three of these standards, TAS R (Reporting Actuarial Information), TAS D (Data) and TAS M (Modelling) were in effect at the date of preparation of this report. My report is intended to comply with all three standards except that, in terms of completeness, I have not considered it necessary or beneficial to policyholders to reproduce or expand on material covered in the company’s report to policyholders to which my report is annexed.

M Godwin

With-Profits Actuary

Zurich Assurance Ltd

23 June 2011