SUMMARY OF PPFM CHANGES

Police Mutual's Principles and Practices of Financial Management (PPFM) sets out how the Managing Board manages the financial aspects of the with-profits business of PMAS and in particular how it exercises the discretion available to it. After the transfer, the PMAS with-profits policies will be managed in line with the Royal London PPFM which has been updated in readiness for the transfer, the 'New PPFM'. The PMAS PPFM also sets out some details for unit-linked and other non-profit business, which will not be included in the New PPFM after the transfer. You can find a copy of the New PPFM on the Police Mutual website: www.policemutual.co.uk.

Some items will be changed to align with the way that Royal London manages its with-profits business. Some items will also remain consistent with the PMAS PPFM. The expected impact of the changes has been considered by the PMAS with-profits actuary and chief actuary as well as the Independent Actuary for the transfer. You can find their reports (the 'actuarial reports') on the Police Mutual website: www.policemutual.co.uk.

The key differences between the New PPFM and those in the PMAS PPFM are also summarised below. The most significant changes are mentioned under the 'Surrender values' and 'Management of the inherited estate' headings. The other changes set out below are not expected to have large impacts on the way the PMAS policies are managed as Royal London have similar intentions in their approach to PMAS.

The New PPFM will cover the following policy types:
PMAS' conventional with-profits (CWP) policies: Regular Savings Plan, Low Cost Endowment, Minimum Low Cost Endowment and Children's Bond.
PMAS' unitised with-profits (UWP) policies: Platinum Bond, Guaranteed Investment Bond, Guaranteed ISA, Protected Growth OISA, Non Guaranteed OISA, Top-up Pension Plan and Group Personal Pension.

Our Overarching Principle

The Overarching Principle sets out the considerations for the PMAS Managing Board when exercising its discretion in relation to with-profits policies. Royal London has equivalent Guiding Principles which cover similar considerations but reflect Royal London's corporate governance structure. Its guiding principles include consideration of the terms of any transfer, including this transfer. If there is any discrepancy between the New PPFM and the terms of the transfer then the terms of the transfer would be used in managing the PMAS policies going forwards.

Asset Shares

Asset share is the value used as a benchmark for setting bonuses on with-profits policies. The PMAS PPFM also has a separate but similar concept, the share of the Life Fund attributable to a policy. The start point for the asset share used after the transfer will be this share of the Life Fund attributable to a policy. The asset shares of the PMAS with-profits policies will be accounted for separately from other business in the Royal London Main Fund. The PMAS asset share calculation will be harmonised with the approach to be used by Royal London after the transfer. This will include the following changes:

- Adjustments will no longer include adjustments reflecting the management of the PMAS inherited estate. There could be adjustments reflecting the management of the Royal London estate and the management of the Notional Account – see 'Management of the inherited estate' below; and
- Mortality charges for PMAS CWP policies' asset shares will now be reflective of the mortality experience for the overall Royal London Main Fund and not the PMAS specific experience.

All other aspects of the calculation will remain the same.

Bonus setting
Bonus treatment for with-profits policies can be split into two categories, regular bonuses and final bonuses. The Royal London principles for setting these are similar to those used by PMAS.

Royal London will follow an equivalent approach for setting regular bonuses and consider the same factors. The PMAS PPFM includes a practice that the change in bonus on sum assured percentage will be no more than 1% each year. The statement of this practice will not be carried over to Royal London. However, that does not mean that Royal London would not consider restricting the size of the change if that was, in the opinion of the With-Profits Actuary and With-Profits Committee, felt to be appropriate. Regular bonuses are already zero for the majority of PMAS with-profits policies, so the limit is unlikely to be relevant.

The following changes will be made to the practices for final bonus setting in the New PPFM:

- The payout range targeted for final payouts, as a percentage of asset share, will change from 80% - 120% pre-transfer to 80% - 130% for CWP policies and 75% - 125% for UWP policies post-transfer;
- The factors considered when setting the final bonuses for the CWP policies will change slightly post-transfer, although the PMAS and Royal London approaches are broadly the same; and
- Currently, Children's Bond and Minimum Low Cost Endowments have adjustments applied to their final bonus to allow for slightly different product features compared to the Regular Savings Plan and Low Cost Endowment. These adjustments will no longer be explicitly made by Royal London but their effect is expected to be captured under the Royal London smoothing approach.

Surrender values
The approach to setting surrender values will be aligned to the Royal London approach post-transfer. These changes will impact the CWP policies and include:

- The removal of a 5% deduction on surrender, such that the surrender value target will now be 100% of asset share; and
- The target payout range for surrenders as a percentage of asset share will change from 75-115% to 80-130%.

The removal of the 5% deduction on surrender is a potentially significant change, especially for those who surrender and is explained further in the actuarial reports.

The principles in the New PPFM allow for a charge for capital to be applied on surrender, this will not be applied to the PMAS with-profits policies - see 'Charges and expenses' below.

Smoothing
The way that smoothing is described in the principles of the Royal London and PMAS PPFMs is different. However, they have similar intentions regarding the purpose of and use of smoothing. There are also practical differences in the way that smoothing is applied which are considered in the actuarial reports on the transfer; PPFM changes are not required to reflect these changes. The intention under both PPFMs is to ensure that, as far as possible, there are no step changes in the benefits received by with-profits policyholders.

Investment strategy
After the transfer, the PMAS with-profits policies will follow the investment strategy of the wider Royal London Main Fund. The principles for the investment strategy are equivalent to those set out in the PMAS PPFM. The equity backing level for the PMAS with-profits policies will initially be increased to match that of the Royal London Main Fund. The New PPFM allows for it to be reduced for PMAS policyholders as part of the management of the Notional Account – see 'Management of the inherited estate'.

The PMAS PPFM practices set out limits for investments in different asset classes in normal circumstances. Limits will not be specified in the Royal London PPFM after the transfer. However, the governance over the investment strategy is similar. Royal London publishes its actual asset mix annually on its website, which PMAS policyholders will be able to access.

Charges and expenses
After the transfer, the charges and expenses will be aligned with Royal London current practices. The principles and practices are consistent with those used by PMAS and equivalent oversight is in place. The charges will reflect Royal London's expenses rather than the expenses of PMAS.

After the transfer, Royal London will initially retain the guarantee charge at its current level. The level of the charge will be subject to review to ensure it remains proportionate to the costs that it is intended to cover. This is consistent with the approach that PMAS currently follows.

The principles in the New PPFM allow for a charge for capital to be made and this is also a principle in the PMAS PPFM. However, the New PPFM practices are clear that this would not be applied to PMAS with-profits policies. This is because a one-off charge for capital will be applied upfront as part of the transfer.

Business activities and risks
The PMAS PPFM sets out that business risks are primarily borne by the inherited estate and the New PPFM has an equivalent approach. The principles for taking on these risks are equivalent. There are practical differences because the Royal London estate is much larger than the PMAS inherited estate and it has many more with-profits policies which share the risks.

Compensation costs
Both PMAS and Royal London Principles set out that any compensation costs would typically be borne by the inherited estate. The New PPFM practices will set out that after the transfer, certain compensation costs relating to the PMAS business would be allocated to the Notional Account.

Management of the inherited estate
The principles set out for the Royal London estate are similar to those used for the PMAS inherited estate.

Additionally, the New PPFM practices will include details of a Notional Account, which will be used to track specific profits or losses which were previously borne by the PMAS inherited estate. The PMAS with-profits business will be directly exposed to changes in the Notional Account, if its value is lower than -£5m or higher than £5m. Details of this profit and loss sharing process are explained in 'Establishment and operation of the Notional Account' within the Summary of the Terms of the Transfer. This profit and loss sharing process is designed to facilitate the fair treatment of PMAS and Royal London policyholders without creating a separate ring-fenced fund for the PMAS business. The New PPFM practices also set out similar sub-divisions of the Royal London estate relating to other business previously acquired by Royal London.

PMAS with-profits policyholders will be exposed to risks borne by the Royal London estate to the extent that those risks result in action being taken across the whole fund. As explained below under 'New business', PMAS with-profits policyholders will not be entitled to any distribution from the Royal London estate.

Currently, the PMAS inherited estate has been used to support the police family and benevolent activities associated with it. These activities will continue after the transfer and the Royal London estate will be used to support the costs.

These changes have the potential to be significant, depending on the future performance of the subsidiaries, and are explained further in the actuarial reports.

Management actions
After the transfer, the PMAS with-profits policyholders will be subject to management actions applied to the Royal London Main Fund. These are similar to the management actions that can be applied to PMAS with-profits policyholders before the transfer. The PMAS with-profits policyholders will also be subject to some management actions that only apply to their policies as a result of the management of the Notional Account.

New business
Royal London's principles in relation to new business are broadly similar to PMAS', noting that the type of business written by Royal London is different from the business that has typically been written by PMAS. The PMAS principles currently state that in the event of closure to new business distributions would be considered. The PMAS with-profits policyholders will not be entitled to any distribution from the Royal London estate.