Teachers Assurance
investing for your future

TEACHERS PROVIDENT SOCIETY LIMITED

PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

1. **Introduction**

1.1 The Financial Services Authority (FSA) requires a firm to pay due regard to the interests of customers and treat them fairly. This document, known as Principles and Practices of Financial Management (PPFM), describes how Teachers Provident Society Limited (the Society) manages its With-Profits Fund, and has been produced in accordance with the FSA's Conduct of Business Rules at 1 November 2011. 'Teachers Assurance' is a trading name of Teachers Provident Society Limited. Where the name is used it covers all subsidiary companies/businesses of the Society.

1.2 The Principles state the overarching business standards adopted in managing the With-Profits Fund and how they will be applied in responding to longer term changes in the business and economic environment. They apply to all types of with-profits policy.

1.3 The Practices state the specific approaches to managing the With-Profits Fund and how short term changes in the business and economic environment will be managed. Some Practices are shown separately for conventional with-profits policies and for unitised with-profits policies, to recognise that there are differences in how the two types of with-profits policy operate.

1.4 The PPFM will be reviewed at least once a year. Although it is not expected that frequent changes will be required to the Principles, it may be necessary to change the Practices more frequently in the light of changing circumstances or new product launches.

1.5 Any changes in the Principles or Practices of the PPFM will be authorised by the Society's Committee of Management (COM), taking into consideration advice from the With-Profits Actuary. If there are changes to the Principles, written notice will be sent to with-profits policyholders at least three months in advance of the effective date of the proposed changes. If there are changes to the Practices these will take immediate effect with those policyholders affected being subsequently notified of the changes.

1.6 Independent judgement in assessing compliance with the PPFM and addressing conflicting rights and interests of policyholders is provided by the Independent Reviewing Director.

1.7 The Society's Mission Statement embraces a number of wider business aims, with products or services being sourced either from companies within Teachers Assurance or from external parties:

- The Society aims to be the first choice of those in the education community for educating and helping them to make good decisions to secure their own, and their families', financial well being.
- Through its wide range of good value products and services, the Society seeks to provide simple yet effective solutions for its customers' financial services needs.
- As a mutual, the Society exists for the sole purpose of benefiting its customers and not shareholders. This fact underpins the trust that customers can have in the integrity of the Society and its legitimate aspiration to be their first choice.

1.8 The Society operates one With-Profits Fund. With-profits policies are primarily savings products over a period of 5 – 30 years that offer guaranteed minimum payouts to policyholders on maturity or death.

1.9 This PPFM is applicable to all conventional and unitised with-profits policies, including those conventional with-profits policies that formed part of the transfer of business from Teachers Assurance Company Limited to the Society on 30 June 1999. A list of policy types and whether they are classified as conventional or unitised with-profits business is provided in Appendix 1 to this document.

2. Amounts payable under a with-profits policy

Principles

2.1 The aim is to pay out an amount due under a with-profits policy that:

- is consistent with safeguarding the solvency of the Society and treating all policyholders fairly relative to their reasonable expectations
- includes any relevant guaranteed benefits
- represents an equitable distribution of surplus arising in the With-Profits Fund during the period that the policy has been in force
- follows the approach to smoothing of payouts (described in section 5)

2.2 Approximate methods will be used to determine payouts where in the opinion of the COM the cost of developing a sophisticated approach is not warranted. This may mean that results could be materially different if less approximate methods were used.

2.3 Changes to the methods used to determine payouts will be approved by the COM, having received advice from the With-Profits Actuary and the views of the Independent Reviewing Director as appropriate. As previously mentioned the Society was party to a transfer of business on 30 June 1999 that was approved by the High Court. The Society does not intend to review any assumptions or methods prior to the date of the transfer from Teachers Assurance Company Limited. No changes to the assumptions, parameters or methods used after the date of the transfer will be made unless it can be clearly demonstrated that a significant class of policyholders has been materially disadvantaged.

Practices – All With-Profits Policies

2.4 The amounts payable under with-profits policies have regard to the calculation of asset shares. The main items used in calculating asset shares are:

- premiums accumulated with investment returns
- less relevant expenses
- less tax
- less cost of death cover
- plus profits or losses from policy terminations
- plus profits or losses from certain business risks (see section 7)
- less the cost of guarantees and smoothing where applicable

2.5 Asset shares use the most recently available investment return on the assets hypothecated to match the with-profits liabilities of each product plus, for conventional with-profits products only, an estimated investment return over the remainder of the bonus review period based on long-term economic assumptions and asset mix.

2.6 The allowances for tax deducted from investment returns, or credited in respect of tax relief on expenses, are based on the rules and rates of tax specified by the HM Revenue and Customs, allowing for the tax status of each policy and the tax position of the Society in each year. Any difference in tax amounts deducted from asset shares and payable by the Society is taken from or added to the inherited estate.

2.7 The expenses deducted from asset shares are based on the expenses allocated to the with-profits business subject to any constraints imposed by policy conditions, bonus series or the Society's rulebook. The expense allocation is carried out annually. Certain acquisition expenses are not charged to asset shares. Any expenses related to with-profits business and not charged to asset shares are charged to the inherited estate.

2.8 The costs of mortality charged to asset shares are based on reviews of the experience of the Society.

2.9 Deductions can be made from the asset shares for any relevant guarantees and options, and use of capital. Additions to or deductions from the asset shares may also be made as a result of the profits or losses arising from non-profits business and the voluntary termination of with-profits policies. These additions or deductions to asset shares have not necessarily applied at all times for all policies. The COM, on the advice of the With-Profits Actuary, can introduce a change to these practices if it considers it is appropriate in order to more accurately reflect the asset share for these polices. Any differences in costs arising from policy guarantees and options, or from smoothing of payouts, compared to the deductions made from asset shares are charged to the inherited estate.

2.10 The COM has used a uniform asset mix to date, but for the future the asset mix may vary by nature of guarantee and the duration of with-profits policies. This may occur, for example, to improve equity between different cohorts of policyholders or between conventional and unitised with-profits policyholders or when there is a legal requirement to do so.

2.11 All surrender values are subject to any surrender charges specified in the policy terms and conditions. Guarantees do not apply on early surrender or termination other than for the Guaranteed Individual Savings Account on certain guarantee dates.

2.12 Formal records are maintained each time that bonus rates and amounts payable to with-profits policies are reviewed, with the With-Profits Actuary making bonus recommendations to the COM for their consideration and, if appropriate, approval. This process includes the storage of computer files and associated software used in each bonus review exercise.

2.13 The actual investment return achieved by the With-Profits Fund and the apportionment of actual expenses over products are documented and reviewed internally, prior to an independent review by the With-Profits Actuary. A similar control approach would be followed if changes were proposed to the underlying methodology or parameters.

Practices – Conventional With-Profits Policies

2.14 The following methods are used to determine policy payouts for the main products listed below (see Appendix 1 for more information):

- Tax Exempt Series 1
- Tax Exempt Series 2 and 2A
- Taxable Series 1
- Taxable Series 2

2.15 The total amount payable to conventional with-profits policyholders consists of the sum assured, annual bonuses and a final bonus if appropriate. The total amount payable is based on a calculation of asset share as described in paragraph 2.4 and following paragraphs. In normal circumstances the COM's aim to make a payment on a policy's maturity date of between 85% and 115% of asset share, subject to a minimum payout of the guaranteed benefits. Over the longer term the aim is that aggregate maturity payouts will represent 100% of asset share, subject to a minimum payout of the guaranteed benefits and the impact of the smoothing policy in section 5.

2.16 Conventional with-profits policies are grouped by policy term to determine the current and projected asset shares for a representative policy. The percentage of the asset share used to determine payouts, before smoothing, is decided by the COM based on advice received from the With-Profits Actuary. In determining this percentage the COM will consider the solvency of the Society, the expectations of policyholders and the requirement to treat customers fairly. In normal circumstances, the percentage of asset share used for maturity payments will be between 85% and 115%. When solvency is endangered the COM is likely to reduce the percentage of the asset share that is used to determine payouts before smoothing. It is likely in such a situation that this percentage will be within the lower part of the range.

2.17 The amounts payable on earlier surrender for conventional with-profits policies will tend to fall within 80% to 120% of asset share subject to any costs of surrender and smoothing that may apply (see section 5).

2.18 The payout ranges that are quoted in paragraphs 2.15 - 2.17 above as being a percentage of asset share are target ranges. They will apply to most maturing or surrendering policies. However it is not guaranteed that each payout on a policy will necessarily fall within the applicable range. In order to maintain fairness between policyholders, it may be appropriate in the future to apply different target payout ranges to groups of policies of different type and bonus series.

2.19 For other smaller classes of conventional with-profits products, the same rates of annual and final bonus are used as for the main products stated above. These other smaller classes are:

- Tax Exempt Whole of Life Plan - uses Tax Exempt bonus rates
- Taxable Whole of Life Plan - uses Taxable bonus rates

Practices – Unitised With-Profits Policies

2.20 The following methods are used to determine policy payouts for the main products listed below (see Appendix 1 for more information):

- Teachers Anniversary Bond
- Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1 issued 2005/2006; Series 2 issued from January 2007)
- Regular Savings Plan
- Guaranteed Savings Plan
- Guaranteed Growth Bond
- Guaranteed Individual Savings Account

2.21 The amounts payable on surrender of a Teachers Anniversary Bond will equal the bid value of units less any specified surrender deduction plus a final bonus if appropriate. The total amount payable is targeted to be between 85% and 115% of asset share. Over the longer term the aim is that aggregate surrender payments will represent 100% of asset share, subject to a minimum payout of the guaranteed benefits due on the tenth policy anniversary. In exceptional circumstances the surrender payment will approximate to the asset share through the application of a Market Value Reduction (MVR) to the bid value of units, though no MVR will be applied on the tenth policy anniversary.

2.22 The total amount payable to unitised Tax Exempt Savings Plan (Series 1) and Regular Savings Plan policyholders is targeted to represent 100% of asset share, however payouts can range from 85% to 115% of asset share. On the maturity date only, there is a minimum payout of the higher of a return of premiums plus any annual bonuses or the smoothed asset share explained in section 5.

2.23 The total amount payable to unitised Tax Free Savings Plan (Series 2) and Guaranteed Savings Plan policyholders is targeted to represent 100% of asset share, however payouts can range from 85% to 115% of asset share (apart from during the first 5 years when the value of any mutuality bonus added (see paragraph 3.11) is excluded from the surrender value of a policy). On the maturity date only, there is a minimum payout of the higher of a return of premiums or the smoothed asset share explained in section 5.

2.24 The total amount payable to Guaranteed Growth Bond policyholders is targeted to represent 100% of asset share, subject, on the maturity date only, to a minimum payout of a return of premiums plus the guaranteed rate of return.

2.25 The total amount payable to Guaranteed Individual Savings Account policyholders is targeted to represent 100% of asset share, subject, on guarantee dates specified in the policy conditions, to any minimum guarantee amounts.

2.26 The payout ranges that are quoted in paragraphs 2.21 - 2.23 above as being a percentage of asset share are target ranges. They will apply to most maturing or surrendering policies. However it is not guaranteed that each payout on a policy will necessarily fall within the applicable range. In order to maintain fairness between policyholders, it may be appropriate in the future to apply different target payout ranges to groups of policies of different type and bonus series.

3. Setting annual bonus rates

Principles

3.1 The aim is to set an annual bonus rate for each bonus series that:
- reflects the surplus arising during the year
- increases the guaranteed benefits on applicable with-profits policies to reflect actual and anticipated risk-free investment returns on the With-Profits Fund
- leaves a margin between a fair market value of policyholders' assets and guaranteed benefits; and
- ensures that the future solvency of the Society can be adequately maintained

3.2 To allow for the different characteristics of with-profits policies, the aim is to maintain separate bonus series for:
- tax status of policies
- types of policy - conventional and unitised policies
- premium rates

Practices – Conventional With-Profits Policies

3.3 Separate scales of annual bonus are used for the following series of conventional with-profits business (see Appendix 1 for more information):
- Tax Exempt Series 1
- Tax Exempt Series 2 and 2A
- Taxable Series 1
- Taxable Series 2

3.4 The annual bonus for conventional with-profits policies increases the amount of guaranteed benefits and is declared in two parts:
- a bonus rate expressed as a percentage of the sum assured, and
- a bonus rate expressed as a percentage of the annual bonuses added to the policy to date

3.5 For conventional with-profits business the main factors in deciding the rate of annual bonus are:
- accumulation of guarantees
- an aim that the guaranteed benefits of a policy do not represent an unduly large percentage of asset shares. During exceptional circumstances this aim may not be met leading to minimal rates of annual bonus.
- maintaining the adequacy of the ongoing solvency position of the Society under a range of economic scenarios allowing for the costs of the current bonus declaration and the assumed rates of future bonus consistent with each scenario
- the sustainable rate of annual bonus in the future based on the current scale of premium rates

3.6 Annual bonus rates will be reviewed at least once a year as at the end of the financial year. In normal circumstances the Society would not expect to change the rate of annual bonus for any bonus series by more than 1.5%per annum. In exceptional circumstances, for example when the solvency of the Society is endangered, annual bonus rates could be reduced to low levels, or even zero.

3.7 At each bonus review interim annual bonus rates are declared which will apply for all policy claims that arise during the subsequent period up until the next bonus declaration date, which will normally be in the following financial year. These interim bonus rates will be based on the considerations described above.

Practices – Unitised With-Profits Policies

3.8 Separate scales of annual bonus are used for the following series of unitised with-profits business (see Appendix 1 for more information):

- Teachers Anniversary Bond
- Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1 and Series 2)
- Regular Savings Plan
- Guaranteed Savings Plan
- Guaranteed Growth Bond
- Guaranteed Individual Savings Account

3.9 The annual bonus for each unitised with-profits product is declared as one bonus rate expressed as a percentage of the accumulated unit value. For Tax Exempt/Tax Free Savings Plan (Series 1), the Regular Savings Plan and the Teachers Anniversary Bond the annual bonus increases the amount of guaranteed benefits. For Tax Exempt/Tax Free Savings Plan (Series 2), Guaranteed Savings Plan and Guaranteed Individual Savings Account, the annual bonus (called mutuality bonus) does not increase the guaranteed benefits. The Guaranteed Growth Bond does not have an annual bonus.

3.10 For unitised with-profits Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1), the Regular Savings Plan and the Teachers Anniversary Bond the main factors in deciding the rate of annual bonus are:

- accumulation of guarantees
- an aim that the guaranteed benefits of a policy do not represent an unduly large percentage of asset shares. During exceptional circumstances this aim may not be met leading to minimal rates of annual bonus.
- maintaining the adequacy of the ongoing solvency position of the Society under a range of economic scenarios allowing for the costs of the current bonus declaration and the assumed rates of future bonus consistent with each scenario
- the sustainable rate of annual bonus in the future based on the current scale of premium rates

3.11 For the Tax Exempt Savings Plan/Tax Free Savings Plan (Series 2), the Guaranteed Savings Plan and the Guaranteed Individual Savings Account the key factor affecting the annual bonus (called mutuality bonus) is the level of profits arising from miscellaneous sources (see paragraphs 7.7-7.9). Mutuality bonuses are not guaranteed to be paid and will often be zero. When they are paid they are likely to be small.

3.12 Annual bonus rates will be reviewed at least once a year as at the end of the financial year. For the unitised with-profits Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1) and Regular Savings Plan bonus rates are reviewed more frequently, currently at quarterly intervals. In normal circumstances the Society would not expect to change the rate of annual bonus for any bonus series by more than 1.5% per annum. In exceptional circumstances, for example when the solvency of the Society is endangered, annual bonus rates could be reduced to low levels, or even zero.

4. Setting final bonus rates

Principles

4.1 Final bonuses may be added to terminating policies to ensure that the payouts represent a fair return reflecting the experience of the With-Profits Fund whilst the policy has been in force.

4.2 To allow for the different characteristics of with-profits policies, the aim is to have differing final bonus rates that reflect:

- tax status of policies
- types of policy - conventional and unitised policies
- premium rates
- duration inforce of a policy
- accrued guaranteed benefits of a policy

4.3 Final bonus rates can be amended at any time.

Practices – All With-Profits Policies

4.4 Final bonus rates are reviewed at least annually. They may be reviewed more frequently, typically at quarterly intervals if the solvency of the Society is endangered, the current level of payouts significantly exceed the asset share or there is a significant change in the value of assets backing the asset shares of these policies.

Practices – Conventional With-Profits Policies

4.5 The following scales of final bonus (also called terminal bonus on some types of with-profits product) are used (see Appendix 1 for more information):

- Tax Exempt Series 1
- Tax Exempt Series 2 and 2A
- Taxable Series 1
- Taxable Series 2

4.6 The final bonus for conventional with-profits policies is declared as a bonus rate that varies by the term (or duration) of a policy and is currently expressed as a percentage of the annual bonuses added to the policy to date. Final bonus forms part of the payout on policies arising from maturity, death or surrender.

4.7 After having calculated the payouts for maturing policies in accordance with section 2, final bonus rates for each bonus scale are calculated for each integral policy term using the excess amount (if any) that represents the balance of a maturing policy payout after deduction of the guaranteed benefits.

4.8 Final bonus rates are calculated for each bonus series for representative policies at specimen durations. The final bonus rate at other durations is determined by interpolating or extrapolating from these rates. This is done in order to avoid treating policyholders with only small differences in policy term (or duration) from receiving materially different final bonus rates.

4.9 For conventional with-profits policies final bonuses are included in the calculation of surrender values, which are based on a formulaic approach in order to approximate to asset shares.

Practices – Unitised With-Profits Policies

4.10 The Teachers Anniversary Bond is the only unitised with-profits policy that uses a final (terminal) bonus scale.

4.11 The final bonus for the Teachers Anniversary Bond is set as a percentage of the accumulated unit value. Final bonus forms part of the payout on policies arising from maturity, death or surrender.

4.12 The intended practice for the Teachers Anniversary Bond is not to smooth final bonus rates by term.

4.13 The effects of recent economic experience are considered as part of the derivation of the total amount payable under a with-profits policy, as described in section 2. If this means that a Market Value Reduction is applicable to the unit value of the Teachers Anniversary Bond, then this will also apply to any final bonus existing at that time.

4.14 The method of determining payouts for the regular premium unitised with-profits products (Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1 and Series 2), Regular Savings Plan and Guaranteed Savings Plan) means that there is no separately identifiable final bonus scale as such, as the amount of final bonus is specific to each individual policy and represents any excess of the unsmoothed asset share (or for maturities only, the smoothed asset share if this is higher) over the guaranteed benefits.

4.15 The method of determining payouts for the Guaranteed Growth Bond and the Guaranteed Individual Savings Account means that there is no separately identifiable final bonus scale as such, as the amount of final bonus is specific to each individual policy and represents any excess of the unsmoothed asset share over any minimum guaranteed payout.

5. Approach to smoothing payouts

Principles

5.1 The aim of smoothing the amounts payable under applicable with-profits policies is to ensure that:

- the amounts paid out on individual policies in adjoining periods of time reduce the effect of short term fluctuations experienced in investment returns and other sources of profit or loss,
- all types of with-profits policy, allowing for the types of claim that may arise, are treated in a fair and consistent manner,
- in the long term the overall effect of smoothing is expected to be neutral to the ongoing financial position of the Society,
- the smoothed amounts paid out do not have a materially adverse affect on the solvency position of the Society

5.2 The COM, on the advice of the With-Profits Actuary, reserves the right to change, when appropriate, the smoothing policy and the surrender bases for with-profits policies. On unitised policies, a Market Value Reduction can be applied if the change in asset values is deemed significant. This may be necessary in circumstances when investment markets show a significant increase or decline in one or more consecutive years, or when the solvency of the Society is endangered.

Practices – All With-Profits Policies

5.3 The smoothing approaches may vary for each product type and bonus series, though the same approach will apply to all with-profits policies of the same product type and bonus series.

Practices – Conventional With-Profits Policies

5.4 The COM aim to restrict or limit the change in maturing conventional with-profits policy payouts from one year to the next for policies of the same term. The limit will depend on the level of solvency of the Society, the total cost of smoothing and the expected future changes in maturity payouts. In normal circumstances payouts are not expected to vary from year to year by more than 10% if payouts are increased or reduced, subject always to the payment of the guaranteed benefits attaching to a policy. During periods of exceptional circumstances the change in payouts may exceed this percentage in order to treat all policyholders fairly, whether it be in regard to ensuring policyholders receive their fair share of the assets of the With-Profits Fund or to maintain the ongoing solvency of the Society. For example, in 2002 and 2008 the level of solvency of the Society was significantly reduced due to falling equity market returns leading to a decision to significantly reduce both annual and final bonuses in 2002 and final bonuses in 2008. The COM may also decide to exceed the 10% change in payouts, where the financial effect is small, in order to treat members equitably.

5.5 The smoothing effects on payouts arising from death or surrender from the above approach will follow on from the practices described in section 2. Payouts on death will fully reflect the smoothing approach. Surrender payouts will only benefit from a small degree of smoothing due to the aim of paying out approximately the asset share.

Practices –Unitised With-Profits Policies

5.6 For regular premium unitised with-profits products (Tax Exempt Savings Plan/Tax Free Savings Plan (Series 1 and Series 2), Regular Savings Plan and Guaranteed Savings Plan) the maturity payout is based on an asset share smoothed over a period of 24 months prior to a policy's maturity date. Changes in payouts to maturing policies are not constrained and will vary according to the outcome for each individual policy as described in paragraph 2.7. Market Value Reductions are not applicable.

5.7 For the Teachers Anniversary Bond the smoothing approach represents the unit value of a policy (less any surrender charges), except during periods of exceptional circumstances when a Market Value Reduction is applied. The Market Value Reduction will represent the difference between the asset share and unit value for the period that the Market Value Reduction is expected to apply.

5.8 The circumstances when the Market Value Reduction on the Teachers Anniversary Bond is not applicable are on:

- the tenth policy anniversary date
- death payments
- regular withdrawal payments up to 5% of the original single premium

These MVR-free circumstances may not apply to future new unitised with-profits products.

5.9 The amounts payable from the Guaranteed Growth Bond and the Guaranteed Individual Savings Account are not subject to smoothing.

6. Investment strategy

Principles

6.1 The aim of the investment strategy for with-profits business is to:

- invest in a well diversified portfolio of investments that is consistent with treating policyholders fairly in line with their reasonable expectations
- seek to obtain long term capital growth and increased investment income
- reflect the guarantees given to policyholders, and
- ensure the ongoing solvency position of the Society

6.2 The investment strategy applied to assets hypothecated to matching the liabilities of with-profits policies, allow for the characteristics and types of with-profits policy. In particular the determination of investment strategy will consider the acceptable level of equity and property investments given the level of guarantees, available capital and the risk appetite as determined by the COM. Assets in the With-Profits Fund that are matching non-profits liabilities will have separate investment strategies applied that are relevant to the nature and type of each liability. For the remaining assets comprising the inherited estate a separate investment strategy will be applied. This would include investments in subsidiary companies and other assets that are not expected to be traded, which are made in order to meet the wider business aims of the Society.

6.3 The Society allows the assets in the With-Profits Fund to be used for stock lending on a fully secured basis.

6.4 The investment strategy limits the exposure to any one counterparty or legal entity to the lower of either the maximum allowed under regulatory rules or the maximum limit established by the Investment Committee.

6.5 The investment strategy does not rely on assets held outside the With-Profits Fund.

6.6 The investment strategy permits the use of derivatives.

6.7 The investment strategy can change from time to time.

6.8 Control limits will be applied for each asset class and an independent custodian will be used to hold relevant assets.

Practices – All With-Profits Policies

6.9 The Society does not have procedures for the transfer of externally held assets to the With-Profits Fund, as it does not currently rely on any such assets.

6.10 The COM has overall responsibility for the investment strategy and risk management of the With Profits Fund taking advice from the With-Profits Actuary and the Capital Management Group (CMG). The CMG review the investment strategy at least annually. The performance of the investment strategy is monitored regularly, typically monthly, by the Investment Performance Monitoring Group (IPMG), reporting to the Investment Committee (IC). Actions are taken by the CMG, IPMG and IC as deemed necessary.

6.11 The investment strategy reflects the level of guarantees, asset shares and solvency of the Society. The resulting asset mix will vary over time.

6.12 The main classes of asset held by the With-Profits Fund are UK and overseas equities, property, fixed and index-linked interest securities (UK and foreign government bonds, corporate bonds), deposits and cash. The assets are either held directly or through collective investment schemes.

6.13 The Society obtains investment exposure to various classes of asset through the purchase of collective investment schemes, such as unit trusts, offered by external companies. Dealings in collective investment schemes are subject to the normal terms and conditions governing their operation.

6.14 Each class of asset has an asset allocation target expressed as a percentage of the total value of the assets backing the with-profits liabilities and inherited estate excluding the amounts referred to in paragraph 6.18 below. The asset allocation target for each class (and a range for each) are reviewed by the CMG with changes being proposed as a result of investment management recommendations due to changes in investment return prospects or to safeguard the ongoing solvency of the Society. All changes to the asset allocation targets are approved by the With-Profits Actuary and ratified by the COM.

6.15 The long-term asset allocation targets are as follows:

Asset Type	**Target Asset Mix**
UK Equities	40.0%
Overseas Equities	12.5%
Property	7.5%
Fixed Interest (Gilts and Corporate Bonds)	27.5%
Index Linked Bonds	2.5%
Deposits and Cash	10.0%
	100.0%

Details of the current asset mix are available on the Teachers Assurance web-site (www.teachersassurance.co.uk) or can be obtained directly from Teachers Assurance. The actual asset allocation may vary from the long-term target due to the reasons given in paragraph 6.14 above. The reasons given above may mean that the percentage held in equities and/or property could potentially reduce to zero.

6.16 Investment in fixed interest and index-linked securities that are subject to credit risk is limited to a percentage of the corresponding asset allocation target. Credit risk exposure is reviewed by the CMG with changes being proposed as a result of changes in credit risk prospects or to safeguard the ongoing solvency of the Society. Any changes to the credit risk profile or to the investment limit are approved by the With-Profits Actuary and ratified by the COM.

6.17 All investment recommendations for new types of assets are reviewed by the CMG and the With-Profits Actuary, with final approval being obtained from the COM.

6.18 There are a number of assets held within the inherited estate that will not normally be traded due to their importance to the Society:

- the main property asset is the Society's Head Office building and surrounding land. The office sector is considered a suitable area for property investment. The property is held in a subsidiary company with the Society paying rent on a commercial basis.
- the Society owns and manages a number of subsidiary companies in order to meet its wider business aims to provide a range of products and services to members of the Society.

6.19 The profitability and capital requirements of subsidiary companies are reviewed annually.

6.20 There are no limits imposed on investments in the subsidiary companies other than if the level of capital in the Society was deemed to be low by the COM then the investments in the subsidiaries would be reconsidered.

6.21 The returns achieved on the subsidiary companies are used to increase or decrease the inherited estate apart from those returns arising from non-profits insurance business which are attributable to asset shares.

6.22 There are no other assets other than those described above which would not normally be traded.

6.23 Since January 2005 the Society has not used any assets for stock lending purposes.

6.24 The current investment strategy allows the use of derivatives only in very specific circumstances and for very short durations, usually of no more than a single working day. The COM may approve an extension of their use in the future should it become appropriate to use such assets to manage the risks faced by the Society.

Practices – Unitised With-Profits Policies

6.25 The unitised section of the With-Profits Fund for all unitised with-profits policies, apart from the Teachers Anniversary Bond, sold since January 2005 has a target asset allocation as in paragraph 6.15. For practical reasons, from time to time the actual asset allocation may differ because the assets are managed separately.

6.26 The assets backing the Teachers Anniversary Bond form part of the With Profits Fund and follow the same target asset allocation as in Paragraph 6.15.

7. Business Risk

Principles

7.1 The Society takes business risks that are approved by the COM. In deciding on the risks to accept the COM will aim to ensure that:

- the existing policyholders' bonus expectations will not be adversely affected
- the return for taking the risk is consistent with appropriate alternative investments
- the Society has the capital to undertake the risk
- the risk furthers the wider business aims of the Society
- the Society maintains suitable systems and controls for managing the risks

7.2 The Society regularly carries out a risk assessment review and these are presented to the COM. The frequency of the reviews is a function of the level and likelihood of the risk.

7.3 The Society monitors through Internal Audit that the risk control measures in place are operated properly and prompts management when it becomes aware of new risks emerging.

7.4 The asset shares of with-profits policies bear the profits and losses arising from those business risks specifically attributable to the determination of benefits of with-profits policies.

7.5 The profits or losses from all other business risks are borne by the inherited estate, including compensation costs.

Practices – All With-Profits Policies

7.6 The Society does not have a preferred set of limits for the taking on of business risk, though the following elements are common to each risk review:

- The extent to which the Society's objectives are met
- The potential for regulatory breaches
- The potential damage to the Society
- The effect on public relations for the Society
- The adverse cost of the risk

7.7 Profits and losses may arise from the following business risks:

- Non-profits insurance business (this is restricted to profits or losses arising on new business accepted after the transfer of business on 30 June 1999) written in the Society or a subsidiary company
- Voluntary termination of with-profits policies
- Maintenance and servicing of existing business
- One-off or non-recurring expenses that the COM determine to be exceptional
- Relevant guarantees and options attaching to policies

7.8 The profits or losses referred to in paragraph 7.7 are not smoothed from year to year and have to be significant, as determined by the COM, in order for them to be attributed to policy asset shares for use in determining the payouts of with-profits policies. Any profits or losses not deemed significant will form part of the inherited estate. Further the COM may at its discretion determine that losses may be charged to the inherited estate.

7.9 The profits or losses from all other business risks are borne by the inherited estate, including:

- Compensation and other exceptional costs
- Expense over or under-runs from the acceptance of new business
- One-off or non-recurring expenses that the COM determine to be exceptional
- Smoothing of policy payouts and bonuses
- Subsidiary companies (excluding profits or losses attributable to asset shares)
- Third party administration and other new ventures

8. Charges and expenses

Principles

8.1 The aim in applying charges and expenses to with-profits policies is to:

- ensure that the charges and expenses of the Society are a consequence of a fair allocation of such charges and expenses between the various companies within Teachers Assurance
- ensure that the amounts of each charge and expense reflect the accounting policies and practices of the Society where relevant
- ensure that each with-profits policy bears its fair share of each type of charge and expense, subject to any constraints imposed by policy conditions, bonus series or the Society's rulebook.

Practices – All With-Profits Policies

8.2 Expenses and charges apportioned to the With-Profits Fund are based on original cost.

8.3 The total expenses of Teachers Assurance are allocated to individual companies (including the Society) using:

- direct costs that are attributable to specific companies
- other costs that are allocated according to various expense rules such as business volumes, timesheets and number of customers

8.4 The expenses apportioned to with-profits policies comprise:

- new business expenses covering sales, marketing and the administration involved in establishing a new policy
- renewal expenses covering the maintenance and servicing of each inforce policy, including the cost of processing a claim under a policy
- investment expenses covering the investment management and accounting of the assets held by the With-Profits Fund

8.5 Expenses that are considered by the COM to be exceptional or non-recurring are excluded from the expenses apportionment, and are met from the inherited estate. For example, expenditure involving exploration of business partnerships, joint ventures, fines, and unit pricing errors.

8.6 Other charges or deductions to asset shares may represent the costs of guarantees, options, and use of capital and smoothing.

8.7 The Society obtains business management and administration services from a subsidiary company Teachers Management Services (TMS). There is an annual review of the costs allocated from TMS to TPS and to the TPS with-profits policies. The costs allocated from TMS are the original costs and do not include any profit element. The Service Agreement can be terminated at the end of the calendar year commencing after the expiry of six months' notice without any penalty costs.

8.8 Since July 2005 the Society has obtained investment management services from Legal & General Investment Management Limited (LGIM). The Investment Management Agreement with LGIM does not contain any review period and can be terminated with 6 months notice without any penalty costs.

Practices – Conventional With-Profits Policies

8.9 The expenses actually charged to policies' asset shares may differ to the expenses incurred by the With-Profits Fund for reasons such as those described below:

- the expenses charged for new business costs are set equal to those expenses assumed in preparing the illustration of policy benefits at the point of sale, or for Series 1 policies the expense limit defined in the Society's Rulebook in force at the time that the policy was issued.
- the expenses charged to asset shares for ongoing maintenance and servicing are based on an apportionment of actual renewal expenses (excluding exceptional costs) incurred in the With-Profits Fund over the various types of product. For Series 1 policies the renewal expense is subject to a limit defined in the Society's Rulebook in force at the time that the policy was issued.

Practices – Unitised With-Profits Policies

8.10 The expenses actually charged to policies' asset shares may differ to the expenses incurred by the With-Profits Fund for reasons such as those described below:

- the expenses charged for new business costs are set equal to those expenses assumed in preparing the illustration of policy benefits at the point of sale.
- the expenses charged to asset shares for ongoing maintenance and servicing are based on an apportionment of actual renewal expenses (excluding exceptional costs) incurred in the With-Profits Fund over the various types of product.

8.11 Other charges or deductions to asset shares may represent the costs of guarantees, options, and use of capital. For the Teachers Anniversary Bond, Tax Exempt/Tax Free Savings Plan (Series 1) and Regular Savings Plan, a deduction may also be made for the cost of smoothing payouts.

9. Management of the inherited estate

Principles

9.1 The inherited estate is the excess of the assets attributable to with-profits business over asset shares plus an amount to cover the cost of guarantees and smoothing. The inherited estate of the Society:

- will be managed for the purpose of safeguarding the solvency of the Society
- will be managed with the aim of treating the policyholders fairly relative to their reasonable expectations
- will be used to meet capital requirements for regulatory purposes
- will be used to support the smoothing of payouts to with-profits policyholders when appropriate;
- will be used to support business development and provide capital for the Society and its subsidiary companies in order to meet the wider business aims of the Society
- is not inhibited with any constraints arising from past transfers of business

9.2 There is no obligation for the Society to distribute the estate to current members. As a mutual organisation, the inherited estate represents the capital of the Society. The Society does not have a preferred size of the inherited estate, although if in the opinion of the COM the estate is excessively reduced or enhanced then action would be taken to ensure policyholders are treated fairly.

Practices – All With-Profits Policies

9.3 The inherited estate is used:

- to bear the rewards or losses of undertaking certain business risks of the Society, including its subsidiary companies
- to meet the costs of compensation claims and other exceptional costs of the Society as determined by the COM
- to meet the costs of expense overruns or underruns of the Society
- to fund the amounts paid out to policyholders that are over or under the sum of any specific earmarked assets matching associated policy liabilities
- to enable the investment strategy to undertake a higher risk and reward profile, such as maintaining a higher asset allocation in equities or lower credit rated bonds

9.4 Whilst in the past the investment strategy for the inherited estate and the with-profits liabilities has been the same there is no requirement for this to be the case. As the Society's ability to manage its business in a more sophisticated manner improves, it is likely that the investment strategy will be different.

9.5 If the estate is excessively reduced or enhanced then action would be taken to ensure policyholders are treated fairly. For example, if the estate is deemed by the COM to be low then a higher percentage of assets may be invested in fixed interest securities. Alternatively, if the estate is deemed by the COM to have more capital than required, then that part of the estate that is determined to represent excess assets may be used to ensure the ongoing strength and vibrancy of the Society for example by, but not limited to, supporting new business to attract new customers and by being distributed to existing with-profits policyholders. The timing and nature of the use of the excess assets would be determined by the COM.

10. New business

Principles

10.1 In accepting new business the Society will aim to:

- ensure that the capital requirements of each new policy written are adequately covered by the size of the estate expected over the anticipated term of the policy
- ensure that existing with-profits policyholders are not being treated unfairly through any significant diminution in their financial security or reduction in their reasonable expectations of policy benefits compared to the position of the With-Profits Fund ceasing to accept future new business

10.2 In the event of closure to new with-profits business the most appropriate method would be used to distribute the inherited estate, apart from an amount to cover the capital required to properly manage the remaining business of the Society, to eligible policyholders.

Practices – All With-Profits Policies

10.3 Each year the Society reviews its capital (or solvency) position under a risk based approach known as Individual Capital Assessment. In addition a Business Plan is produced containing planned business activities for the following financial year, including new business. The potential volumes of new business for the various product types are constrained in order that the forecast financial position shows an adequate level of the estate for ongoing solvency purposes under the Individual Capital Assessment approach. These constraints act as the maximum levels of new business that can be accepted by the With-Profits Fund.

10.4 There are no constraints on the minimum level of new business to maintain the With-Profits Fund open to new business, with the position being reviewed annually by the COM.

11. Equity between the With-Profits Fund and shareholders

11.1 This section is not relevant as the Society is a mutual organisation and does not have any shareholders.

APPENDIX 1

POLICY TYPES

This Appendix includes a list of with-profits policy types to classify them between 'conventional' with-profits policies and 'unitised' with-profits policies.

Conventional With-Profits Policies

Bonus Series:	Tax Exempt Series 1	Taxable Series 1	Tax Exempt Series 2 and 2A	Taxable Series 2
Policy Type	Savings Growth Plan[2] High Yield Savings Plan Retirement Savings Plan[2] The Friendly Savings Plan Tax Exempt Savings Plan[1] Child Tax Exempt Savings Plan[1]	Savings Growth Plan[2] Retirement Savings Plan[2] Retirement Extra Savings Plan Special Saver 2001 Over 60's Savings Plan Endowment Endowment – Expectations Endowment & Family Income Plan Low Cost Endowment Special Low Cost Endowment Whole of Life Whole of Life With Profit Covercare Whole of Life Whole of Life & Family Income	Tax Exempt Savings Plan[1] Child Tax Exempt Savings Plan[1]	Endowment With Profit
Policies Issued	Up to Feb 1996	Up to Oct 1996	From Oct 1995 to June 2005	From April 1996 to June 2005

Note
[1] These types of policy were issued over more than one bonus series. As a guide to which bonus series applies to your policy, please consider the date your policy was issued by referring to your policy documents. Alternatively please contact Teachers Assurance.
[2] These types of Plan consist of a Tax Exempt and a Taxable policy, the Tax Exempt policy number ends with D01, D02 or D03.

Unitised With-Profits Policies

The following product types are unitised with-profits policy types:

Teachers Anniversary Bond
Tax Exempt/Tax Free Savings Plan (Series 1) – policies issued from January 2005
Tax Exempt/Tax Free Savings Plan (Series 2) – policies issued from January 2007
Regular Savings Plan
Guaranteed Savings Plan
Guaranteed Growth Bond
Guaranteed Individual Savings Account

APPENDIX 2

ABBREVIATIONS

The following is a list of abbreviations used in the PPFM:

COM	-	Committee of Management of Teachers Provident Society Limited
CMG	-	Capital Management Group
FSA	-	Financial Services Authority
IPMG	-	Investment Performance Monitoring Group
IC	-	Investment Committee
LGIM	-	Legal and General Investment Management Limited
MVR	-	Market Value Reduction
PPFM	-	Principles and Practices of Financial Management
Society	-	Teachers Provident Society Limited