

Guardian Assurance plc's
Annual Report to With-Profits Investors
for the year to 31 December 2010

April 2011

In this report you can find details of how we managed our with-profits business in 2010 and how account was taken of our with-profits investors' interests.

About this report

The Financial Services Authority (FSA) requires us to produce a report each year for our with-profits investors stating whether or not, during the financial year in question, we believe we have complied with our stated Principles and Practices of Financial Management of With-Profits Business (PPFM).

But it's not just our word on it. The independent Scottish Equitable Policyholders Trust is involved in the ongoing assessment of our compliance with the PPFM, providing an element of independent judgement throughout the process. (You can find more details on this in the section 'How we make sure we're compliant with the PPFM' below.)

Our PPFM

Our PPFM sets out in detail our with-profits management strategy and processes. You can view it on our website at – www.guardianfs.co.uk – or write to us at Guardian Assurance plc, AEGON House, Ballam Road, Lytham St Annes, Lancashire, FY8 4JZ.

Our PPFM is split into two sections: Principles and Practices. The Principles set out our general approach to the management of with-profits business and are not expected to change often. The Practices cover the day-to-day operation of our with-profits business within the Principles framework.

Guardian Assurance and with-profits

Guardian Assurance plc can trace its history back to 1821 when the Guardian Fire and Life Company was formed. In 1901 Guardian Fire and Life Company was re-branded as Guardian Assurance and in 1968 Guardian Assurance merged with another life office - the Royal Exchange. In 1970, 5 Life Funds (Guardian, Royal Exchange, Atlas, Caledonian and Licences and General) of the combined group were merged to form the with-profits fund ("the Fund") of Guardian Assurance plc.

The Fund contains both with-profits and non-profit business including unit-linked business. The with-profits policyholders receive 90% of the profits arising in the Fund and the shareholder receives 10% of the profits. The ultimate shareholder is AEGON nv, a large multinational insurance group based in The Netherlands.

In 1998 the Fund was restructured and became closed to new business. As part of the restructure the Fund received a cash injection from the then shareholder in return for 70% of the future profits arising on the major classes of unit-linked business written in the Fund. The cash injection was invested in the Fund. The shareholder continues to receive 70% of the relevant profits as they arise.

Since the Fund became closed to new business, the estate held within the Fund is no longer required as working capital and is being distributed gradually to the with-profits policyholders by way of higher bonus rates than would otherwise have been the case. Only with-profits policies that were in-force at the time of the announcement of the restructure benefit from the distribution of the estate.

All with-profits contracts offer a guaranteed rate of return. The rate varies by type of with-profits contract and over the years the Fund has written a large variety of with-profits contracts as described below. Note that references to guarantees are in the context of the specific points in time where guarantees may apply (e.g. maturity, death, retirement at selected retirement date, regular income withdrawals, withdrawals at a specific anniversary). Guarantees do not generally apply on early surrender.

The main classes of with-profits business are:-

Deferred annuity contracts namely:-

- Pension Plus
- Versatile Individual Pension Plan
- Buy-Out Plan
- Personal Pension
- Participating Pension
- Chargeable Rates
- Deposit Administration
- Pension Saver

Life Assurance contracts namely:-

- Endowments
- Whole of Life

Unitised With Profits contracts namely:-

- Freedom
- Choices

How we make sure we're compliant with the PPFM

We take advice from the With-Profits Actuary on all aspects of the operation of with-profits business. This ranges from bonus declarations to the systems and procedures needed to treat with-profits investors fairly. The With-Profits Actuary advises on whether any changes we make are consistent with the PPFM and produces routine reports for us. One of these is a detailed report explicitly covering compliance with the PPFM during the previous financial year.

Also, the Scottish Equitable Policyholders Trust Limited provides an element of independent judgement on compliance with the PPFM. Its Board (which is independent of Guardian Assurance plc) meets regularly throughout the year and its directors take advice from an independent actuarial adviser (who also sits on the Board of Scottish Equitable Policyholders Trust Limited). At these Board meetings, the attendance of the With-Profits Actuary, as well as certain directors and management of Guardian Assurance, is required. All reports from the With-Profits Actuary to Guardian Assurance plc's directors are also given to Scottish Equitable Policyholders Trust Limited. As a matter of course during the year, the With-Profits Actuary routinely discusses matters with the independent actuarial adviser.

Our with-profits decisions

Within our with-profits business, we have discretion (in other words we make all the decisions as to what to do) in the following key areas:

- Investment policy
- The level of annual bonus rates
- The level of terminal bonus rates, market level adjustments and surrender values
- The level of expenses allocated to asset shares
- The level of taxation allocated to asset shares
- Deductions for the expected future costs of guarantees within the calculation of asset shares

- The level of Bonus Surplus allocated to asset shares from the distribution of the estate. (The estate is the excess assets over and above the amount required to meet liabilities to investors.)

Investment policy

The investment policy is set out in Section 4.6 of the PPFM. The investment mix of each with profits policy differs depending on the maturity of the business and the proportion of the final pay-out which is guaranteed. The Fund adopts a close matching policy such that any guaranteed payouts, including basic sums assured, annual bonuses and annuities in payment are matched in terms of size and timing by the projected cash flows from the fixed interest assets held.

Benefits that are not guaranteed, such as accrued terminal bonus, are generally backed by UK equities. The estate is invested in a mixture of UK fixed interest securities and UK equities. Further details are given in the PPFM.

The investment strategy adopted during the year has been consistent with that set out in the PPFM and the equity backing ratios, which vary from class to class and also by duration, have been in the range set out in the PPFM.

The gross investment returns achieved over the 12-month period to 31 December 2010 were used directly in the calculation of the asset shares during 2010 based on the assumed asset mix of the relevant asset share.

Annual bonus rates

The relevant practices are set out in Section 4.3 of the PPFM. The practices set out that, for other than Deposit Administration, Pension Saver and Group Funding, annual bonus rates were reduced at the 31st December 2004 declaration to such a level that no further reductions were planned. Consistent with this approach, for the relevant classes of with-profits business, the annual bonus rates declared for 2010 were equivalent to the rates for 2009.

The declared yearly bonus rates are given below, with the previous year's rates for comparison.

Yearly bonus declared in arrears

	31 December 2010	31 December 2009
Pension Plus	0.5%	0.5%
Versatile Individual Pension Plan	0.5%	0.5%
Buy-Out Plan	0.5%	0.5%
Personal Pension	1.0%	1.0%
Participating Pension	1.0%	1.0%
Chargeable Rates	2.6%	2.6%
Life Assurances	1.0%	1.0%

Yearly bonus declared in advance

	1 April 2010	1 April 2009
Choices Unitised With Profits – Basic / Bonus Interest Rate	0.5% / 1.0%	0.5% / 1.0%
Freedom Unitised With Profits	1.25%	1.25%

Terminal bonus rates, market level adjustments (MLAs) and surrender values

The relevant practices are set out in Sections 4.4 and 4.5 of the PPFM. The amounts payable under Deposit Administration and Pension Saver are predominantly based on 15 year gilt yields and the amounts payable under Chargeable Rates policies are based on the relevant premium rates and fixed interest yields. For Deposit Administration, Pension Saver and Chargeable Rates this approach has been followed throughout 2010.

For other classes of with-profits business the calculation of asset shares is fundamental to the amount payable. The way in which asset shares should be calculated is described in section 4.2 of the PPFM and asset shares were calculated in this way throughout 2010.

Terminal bonus rates are determined having regard to any excess, for groups of policies, of asset shares above the value of the guaranteed benefits including annual bonuses added. Terminal bonuses are reviewed monthly and the practices explain the circumstance that results in changes to terminal bonus rates. The practices explain that for the majority of deferred annuity business the guaranteed benefits at retirement exceed the asset share by a significant amount and hence the terminal bonus rate is zero. The application of a MLA is assessed on a policy by policy basis and the practices detail the circumstances under which a MLA will be applied with respect to unitised with-profits business. These practices have been followed throughout 2010 and terminal bonus rates were amended for certain classes of business with effect 1st April 2010, 1st September 2010, 1st November 2010 and 1st January 2011.

Expenses

Section 4.8 of the PPFM explains all normal management and administration expenses are met by the shareholder through a shareholder owned service company. The Fund pays the shareholder an agreed level of expense based on an agreed amount per policy. The amount varies by type of policy and increases each year at a rate equal to the increase in the retail price index plus 1%. The Fund pays an agreed annual management charge to the shareholder for investment services, which is currently 0.085% per annum for bonds, 0.16% for equities and 0.05% for cash. The level of expenses borne by the Fund and similarly the amount of expenses allocated to asset shares during 2010 was consistent with these agreements.

Taxation

Section 4.2 of the PPFM states that the investment returns allocated to asset shares are adjusted for taxation where appropriate. Hence, the investment returns allocated to the life business are reduced for taxation whereas the returns with respect to pension business are not reduced. Any difference between the tax allocated to asset shares compared to the overall tax assessment of the Fund emerges as a miscellaneous profit or loss and is allocated to the estate. Since 30th June 2005, the additional tax resulting from the transfer out of the Fund of the shareholder's share of profits is met by the estate whereas previously it was charged directly to asset shares.

Deductions for guarantee costs

During 2010 no deduction was made for the cost of guarantees as such costs are currently met by the estate as outlined in Section 4.9 of the PPFM.

Estate

The approach to managing the estate is set out in practice 4.9 of the PPFM. The intention is to distribute the estate equitably to with profits policies in force at the time of the Fund's restructure at the end of 1998 by using Bonus Surplus to enhance asset share returns. Consistent with this intention, for 2010 a Bonus Surplus of 2.5% was declared, increased from 2% for 2009.

Consistent with the practices, the estate was also used during 2010 to provide capital support towards meeting the regulatory solvency requirements, the cost of guarantees, smoothing costs and any compensation or redress in connection with the way business written in the Fund has been marketed or sold.

Our directors' opinion on our with-profits management in 2010

We can confirm that, throughout 2010, we have met the requirements of the PPFM and we have exercised our judgement fairly, taking into account the interests of with-profits investors in a fair and reasonable manner. Our governance arrangements involve Scottish Equitable Policyholders Trust Limited providing some independent judgement in the assessment of our compliance with the PPFM. We continue to be satisfied with the operation of these arrangements (and the judgement exercised) throughout 2010.

The directors of Guardian Assurance plc April 2011

Statement by the With-Profits Actuary

I can confirm that, in my opinion, the company's 2010 annual report and the discretion exercised by the company during 2010 have taken the interests of with-profits investors into account in a reasonable and proportionate manner. In reaching this conclusion I have taken account of the information and explanations provided to me by the company as well as the relevant rules and guidance of the Financial Services Authority, the Board for Actuarial Standards and the Actuarial Profession.

Andrew Pennington Fellow of the Institute of Actuaries With-Profits Actuary, Guardian Assurance plc April 2011

We're not allowed to give you advice, but if you'd like any further information on our with-profits contracts and how we run them, please contact us.

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