

# A guide to how we manage our with profits fund

## About this guide

This guide tells you:

- how we manage our with profits fund
- how our with profits policies work
- what benefits policyholders can expect from them.

We use certain terms in this guide that need a more detailed explanation than we can give in the text. We have highlighted these *like this* and included them in a summary of useful terms at the beginning.

## Who should read this guide?

You should read this guide if you have a *unitised* with profits policy (including an Individual Savings Account (ISA) invested in with profits) that was taken out with *Royal London* or with *Refuge Assurance*. It explains how we currently manage the *Royal London with profits fund* and how this affects your policy.

We refer to the '*Royal London with profits fund*' as the 'fund' throughout the rest of this guide.

You should read this guide and keep it safe with your other policy documents, which you may find helpful to refer to as you go through it. The guide does not change the terms of your policy; it gives you further information to help you understand it better.

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## 1 Useful terms

### Asset share

The accumulation of premiums paid into a policy after taking off amounts to cover expenses, charges and tax (for life policies) and after crediting or debiting amounts to reflect the investment returns achieved by the fund. From time to time we may also make adjustments to allow for any increases (or enhancements) to *asset share*. We also take off a *transfer to working capital* from the *asset shares* of policies taken out with *Refuge Assurance*.

### Industrial Branch

Policies which, when taken out, had a premium receipt book as well as a policy document. When the policies were taken out, premiums were payable to a collector.

### Market value reduction

A reduction that we may apply to the value of a policy when part or all of it is being cashed in. We apply it to ensure that we treat everyone in the fund fairly, both those leaving it and those staying in it.

There are certain circumstances where we cannot apply a *market value reduction*, for example: at the end of the policy term, at the pension date originally specified or on death.

For some with profits bonds we cannot apply a *market value reduction* if you cash in units on the tenth anniversary of buying them. In general, with profits bonds issued after April 2001 do not include this exception.

We cannot apply a *market value reduction* to with profits ISAs taken out before 6 April 2001.

Please refer to your policy document for the circumstances that apply for your policy.

### Members

*Members* are policyholders who 'own' *Royal London*. They can attend the Annual General Meeting and vote. Some categories of with profits policyholder are not *members*, including policyholders whose policies were formerly with *Phoenix Life Assurance*, *Refuge Assurance*, *Scottish Life* and *United Friendly*.

### Ordinary Branch

All pension policies; and life policies which, when taken out, had premiums payable in a lump sum, or every three, six or twelve months, or monthly from a bank account.

### Phoenix Life Assurance

Phoenix Life Assurance Limited.

### Quarterly pool

For the purposes of setting final bonuses and *market value reductions* units bought in a calendar quarter are usually pooled together. However we may decide to create other pools of units, for example following a very large market movement.

### RAIB sub-fund

The *sub-fund* into which *Refuge Assurance* with profits *Industrial Branch* policies were transferred.

### Refuge Assurance

Refuge Assurance Plc.

### RL sub-fund

Contains all the policies in the *Royal London with profits fund* that are not held in the *UFIB sub-fund*, the *RAIB sub-fund* or the *UFOB sub-fund*.

### Royal London

The Royal London Mutual Insurance Society Limited.

### Royal London with profits fund

The fund that consists of the with profits and non profit policies of *Royal London* including all transferred policies from *Refuge Assurance* and *United Friendly*

and non profit policies transferred from *Phoenix Life Assurance* and *Scottish Life*. The with profits policies are held in four *sub-funds*; the *RL sub-fund*, the *UFIB sub-fund*, the *RAIB sub-fund* and the *UFOB sub-fund*.

The with profits policies transferred from *Scottish Life* are in a separate fund, the *Scottish Life Fund*. The with profits policies transferred from *Phoenix Life Assurance* are in a separate fund, the *PLAL With-profits Sub-fund*.

### Scottish Life

The Scottish Life Assurance Company.

### Smoothing

The way in which we reduce the impact on policyholder payouts of the variation (sometimes quite a large variation) in the returns earned year on year by the fund.

### Sub-fund

The *Royal London with profits fund* has four *sub-funds*; the *RL sub-fund*, the *UFIB sub-fund*, the *RAIB sub-fund* and the *UFOB sub-fund*.

### Transfer to working capital

This transfer is the same transfer that was previously made to shareholders of *United Assurance Group*. The right to this transfer was given to *Royal London* when it bought the shares of *United Assurance Group*.

### UFIB sub-fund

The *sub-fund* into which *United Friendly Industrial Branch* with profits policies were transferred.

### UFOB sub-fund

The *sub-fund* into which *United Friendly Ordinary Branch* with profits policies were transferred.

### United Assurance Group

Consisted of *Refuge Assurance*, *United Friendly* and other companies writing non profit business and/or other non life assurance business.

### United Friendly

United Friendly Insurance Plc.

### Unitised

A with profits policy such as yours where premiums are used to purchase units in a with profits fund.

### With profits bond

A *unitised* with profits life policy where the premium is paid in a single lump sum.

### Working capital

The amount by which the investments of the fund are greater than the amounts already promised to policyholders by way of guaranteed amounts and bonuses.

## 2 Principles and Practices of Financial Management

We manage the fund by following our Principles and Practices of Financial Management (PPFM). You can read the current PPFM by visiting our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk)

The Principles are high level statements setting out how we intend to manage the fund over the long term. The Practices are more specific statements that describe how we intend to follow the Principles in managing the fund on a day-to-day basis.

The PPFM is a very detailed technical document so this guide sets out a summary of the key points in simpler terms. If there is any conflict between the simplified wording in this guide and that in the PPFM, we will apply the wording in the PPFM.

We will publish changes to the Principles and Practices on our website [royallondongroup.co.uk](http://royallondongroup.co.uk). If the changes are significant, we'll send you an updated copy of this guide with your yearly statement.

## Our Guiding Principles

We follow some overall Guiding Principles when managing the fund:

We will manage the fund in a sound and prudent manner and aim to:

- make sure that, at the appropriate time we can pay all the amounts guaranteed to our policyholders
- uphold all policy terms and conditions
- satisfy our regulator, the Financial Services Authority, that we are managing the fund in an appropriate way
- treat all our policyholders fairly.

We have appointed an independent person to provide advice on the way we manage the fund and to help us treat with profits policyholders fairly and monitor our compliance with the PPFM.

## 3 What is a with profits policy?

A with profits policy is a legal contract between you and us. The premiums that you pay us are used to buy units in the fund at the unit price applicable on the day you buy them. The price of the units increases regularly as we recalculate the price to allow for the addition of regular bonuses.

The fund invests in a wide range of investments and with profits policyholders share in the profits and losses made on these investments. Instead of receiving direct investment returns such as dividends or interest, with profits policyholders receive bonuses, which we add to their policies.

*Royal London* is a mutual society which means that we do not have any shareholders. All the profits and losses made by us remain in the business for the benefit of policyholders and *members* rather than a share of the profits being paid to shareholders.

If your policy is a *with profits bond* taken out with *Refuge Assurance*, a share of the profits is paid to the shareholders of *United Assurance Group*. As a result of the transfer of the policies to *Royal London* on 1 January 2001 these payments are now made to *Royal London's working capital*.

The amount we promise to pay you will be the face value of the units you hold in the fund on the set event or date in your policy schedule. We may also add a final bonus on this date.

The set event or date may be:

- when you take your pension benefits at the pension date
- the date of death if you should die before the end of the policy.

There may also be other times when we will pay you this amount. Your policy documents contain details of when we will pay you this amount.

## The bonuses

We aim to increase the value of your units throughout the term of your policy by declaring regular bonuses which increase the unit price. We recalculate the unit price daily.

We may also pay a final bonus when you cash in some or all of the units allocated to your policy. If you do this before the set event or date in your policy, for example by making cash withdrawals above a certain limit, transferring your policy or taking your pension benefits before your pension date, we may pay you less than the face value of the units by applying a *market value reduction*.

There are more details on the bonuses we pay and the *market value reduction* in section 5 – 'How do you decide bonuses?'

## 4 How do you decide how much to pay me?

We base the amount we pay you on the face value of the units you hold in the fund at the date you decide to leave the fund. We may also pay you a final bonus and we may reduce the total value we pay you if you:

- cash in some or all of the units in your policy, or
- transfer it, or
- take your pension benefits before your pension date.

When determining how much we will pay you we aim to be fair to you and to the other policyholders remaining in the fund.

We use *asset shares* to help us decide how much to pay you at the set event or date in your policy schedule or on death.

This is how we calculate *asset shares*.

- We start with the premiums paid into the fund.
- Then we take off our expenses, tax (for life policies) and the cost of providing benefits and guarantees to the policies. For certain policies taken out before 1 January 2001, we also make a *transfer to working capital*.
- Then we allow for the investment returns earned by the investments backing the policy in each quarter of each calendar year. Before 1 January 2010 the investment returns were the same for all policies in the fund. Since 1 January 2010 the investment return we allocate varies according to the *sub-fund* the policy is in and how long the policy has left to the end of the policy term. Your policy is in the *RL sub-fund*.

We also include any enhancements we have made.

We calculate sample *asset shares* based on a *quarterly pool* of units bought. We calculate sample asset shares so that we can keep track of the relationship between the amounts we pay you and the investments available in the *RL sub-fund*. This ensures that the bonuses we pay are fair across the whole range of with profits policies.

*Asset shares* are simply a measuring tool. We use the sample *asset shares* to set bonus rates and we use *asset shares* in total to assess the *working capital* within the fund. We do not quote *asset shares* on individual policies.

We compare the sample *asset share* with the value of the units held in the fund for your *quarterly pool*.

If the *asset share* is higher than the value of units held in the fund for your *quarterly pool*, we may pay a final bonus. However the amount of final bonus we pay also depends on the amount of *smoothing* that we apply at the time of payment.

If the *asset share* is lower than the value of units held in the fund for your *quarterly pool*, we may apply a *market value reduction*.

We apply *smoothing* to the amounts we pay to make sure we pay your fair share of the fund when your policy ends.

We explain *smoothing* in section 6 – ‘What is smoothing and how do you apply it?’

The range in which we aim to target most maturity values as a percentage of *asset share* is 75% to 125%.

At any time we may change the way we determine how much each policy receives in the future but only if the change is fair.

## 5 How do you decide bonuses?

We usually announce the rate of regular bonus once a year. We may change the rate more often than once a year and we can change it at any time.

We usually announce the rates of final bonus every three months but we can change them at any time if we need to reduce the amounts we pay to policyholders leaving the fund to protect the interests of remaining policyholders if, for example, investment conditions are bad. Alternatively we may need to increase the amounts we pay if, for example, investment conditions are exceptionally good.

### Regular bonuses

We announce regular bonuses that increase the unit price used to calculate the value of your policy gradually over the policy's lifetime. Once added, a regular bonus becomes part of the unit price and cannot be taken away. However in some circumstances we may not pay you the face value of the units.

We decide regular bonus rates by considering what we think the fund can afford to pay now and in the future. To do this we look at current investment conditions and the economic outlook for the future.

If we feel that announcing a regular bonus would harm the ability of the fund to pay the amounts promised to policyholders when they are due either now or in the future, we may decide not to announce a regular bonus.

We may announce different regular bonuses for different types of policy in order to treat each policy group within the fund as fairly as possible (for example life policies and pension policies).

We try to introduce changes to the amount of regular bonus we announce gradually over time.

### Final bonuses

We may also announce a final bonus. We do this to increase what you get back from your policy if the regular bonuses we have added to your policy do not fairly reflect the sample *asset shares* that we have calculated for your particular type of policy.

We compare the sample *asset share* with the value of the units held in the fund for your *quarterly pool*. We determine a scale of final bonuses after we have applied the appropriate *smoothing*.

We may change final bonuses at any time in order to protect the fund and to ensure that all policyholders receive their fair share in both good times and bad times. There are no restrictions on the size of final bonus that we might pay or how much it might change from one period to the next. We might not pay any final bonus.

Final bonuses are NOT guaranteed in any circumstances.

### Market value reduction

We may apply a *market value reduction* if you cash in or transfer your policy or if you cash in units on occasions described in your policy document. This is to ensure that the amount we pay you is not unfairly higher than the underlying *asset share* of the policy at that date and that the remaining policyholders in the fund are not unfairly treated.

For the group of policies that best represents your policy we compare the sample *asset share* with the value of the units held in the fund. If the sample *asset share* is less than the value of the units held in the fund, we will determine a scale of *market value reduction* factors.

We usually announce these factors every three months but we may change them at any time in order to protect the fund and ensure that all policyholders receive their fair share in both good times and bad times. There are no restrictions on the size of the *market value reduction* that we might apply or how much it might change from one period to the next.

We will not apply *market value reduction* factors in the circumstances specified in your policy document or schedule.

Some examples of these circumstances include:

- at the pension date originally specified
- on death
- cashing in units on the tenth anniversary of purchase for some with profits bonds, generally those taken out before April 2001
- cashing in units in a with profits ISA taken out before 6 April 2001.

Please check your policy document to see which circumstances apply to your policy.

We will not apply a *market value reduction* unless it is justified to ensure fairness.

## 6 What is smoothing and how do you apply it?

*Smoothing* is one of the main features of with profits business that we have to consider when determining the payout for a with profits policy. It is one of the key ways in which we can be fair to all policyholders.

The fund invests in a range of assets and the value of these goes up and down, sometimes significantly, over time. One year a particular investment may do very

well, the next its value could fall sharply.

We try to add regular bonuses in a way that protects policyholders to some extent from large falls in the investments held by the fund. Instead of adding big bonuses in good years and small or no bonuses in bad years, we try to smooth them out. So we hold back some of the investment gains earned during good years and release them as bonuses when returns have been poorer or seem likely to get poorer or when the fund has made a loss.

Before we announce the bonuses, in order to decide how much *smoothing* to apply, we will:

- look at how much *working capital* the fund has in comparison with the target amount we would like to have to develop the business (for example for issuing new policies)
- consider how much regular bonus we should announce and how much this bonus will cost
- assess how much money we think we need to keep in the fund to maintain its financial strength and satisfy the requirements of our regulator, the Financial Services Authority.

Although bonus rates may go up or down, or we may decide not to announce a bonus at all, they will usually be much more stable than the returns on the investments held by the fund.

We aim for the effect of *smoothing* to cancel itself out over the long term. This means that, over time, the amounts we hold back in good years should offset the amounts required in bad years.

We aim to be consistent between different types of policyholder (for example people who hold life or pension policies) and policyholders leaving the fund today and those that will leave in the future.

*Smoothing* protects the financial interests of all policyholders remaining in the fund. We still apply *smoothing* to policies that are cashed in or transferred early, but not as much.

## 7 How do you decide how much to pay me if I cash in or transfer my policy or stop paying premiums early?

If you cash in some or all of the units allocated to your policy or transfer your policy, we need to work out how much to pay you in order to be fair to you and to those remaining in the fund.

We may pay a final bonus in these circumstances but this may be at a rate that is lower than you would normally get if you kept your policy for the full term and, depending on the type of policy, continued paying premiums. We may not pay any final bonus at all.

We may pay less than the value of units and any final bonus added by applying a *market value reduction*. We apply this when the *asset share* for a policy is lower than the face value of units plus final bonus. The *market value reduction* ensures fairness between those policyholders who leave the fund early and those who remain.

Payments when you cash in or transfer your policy may be reduced to protect remaining policyholders and allow for expenses we have incurred that we have not managed to cover out of the premiums already paid.

The range in which we aim to target most payments when you cash in or transfer your policy as a percentage of *asset share* is 75% to 125%.

## 8 How do you decide the investment strategy?

Our investment strategy aims to obtain the best possible returns for policyholders while still making sure that we can pay all their guaranteed amounts. It also aims to provide some stability in investment returns for policies as they approach the end of their term.

We do this by investing mostly in a mixture of company shares, property, government bonds, other bonds and cash.

Usually the investments that provide the best long term return are also the most risky (for example company shares). We therefore invest some of the fund in investments where the return is guaranteed or more stable (for example government bonds).

Before 1 January 2010 we managed the fund as a single collection of assets. All policies in the fund were invested in the same asset mix and received the same investment return.

On 1 January 2010 we changed our investment strategy so that each of the four *sub-funds* now has its own collection of assets. Your policy is in the *RL sub-fund*.

In addition, for each policy we now gradually reduce the proportion invested in company shares and property and increase the proportion invested in government and other fixed interest bonds and cash as the policy gets closer to the end of its term.

We do this because we believe that being invested in more stable assets towards the end of the policy term is in the best interests of most policyholders.

We also take into account:

- the size of the *working capital* as a 'cushion' against bad times
- the expected return from each type of investment we hold
- the expected variability of the returns from each type of investment.

We 'match' certain types of guarantee with appropriate investments such as government bonds or cash. By 'match' we mean that we hold investments that move in a similar way and have a broadly similar period to run as the guarantee itself.

We have a committee that regularly reviews the proportions held in each of these types of investment. The committee must work within guidelines agreed in advance to achieve an appropriate balance of risks.

In recent years up to the end of 2009 the typical investment mix underlying the with profits *asset shares* of all policies in the fund was around 40% in company shares, 15% in property, 40% in fixed interest investments and the balance in cash and a variety of other investments.

In 2010 we expect the investment mix underlying the *asset shares* of policies with more than 10 years left until their maturity date to be around 70% to 75% in company shares and property. This proportion will change from time to time as a result of our investment decisions and changes in investment markets. However, we expect changes to be gradual.

By the end of a policy's term we expect to have gradually reduced the proportion in company shares and property to around 25% or lower and increased the proportion in government bonds, other bonds and cash.

For policies that are open-ended (meaning they don't last for a fixed number of years) and do not have a maturity date, we have set the investment mix after estimating when we will pay the policy's value.

## 9 How might your business activities affect my payout?

The fund undertakes a number of different business activities. These are only undertaken once we have taken suitable professional advice and are happy that the proposed business activity fits within the fund's risk guidelines.

We undertake these activities because we expect that the rewards from the activity will outweigh the risks. For example, we issue new policies in the fund in the expectation that the long term profits from issuing these policies will generate extra bonuses for our with profits policyholders. The risk is that the new policies turn out to be less profitable than we expected or to be unprofitable.

Some risks associated with business activities are unavoidable and we have to manage them carefully. For example there is the risk that the charges we make to cover our expenses may not be enough to cover our costs.

We manage these activities to produce as high a return as possible while keeping track of the risks that may arise and looking for opportunities to improve the profitability of the businesses. This key responsibility drives much of our regular internal reporting and planning.

## 10 What are the expenses and how do you charge for them?

The expenses broadly cover the set up costs, any commission paid, ongoing administration costs and investment management costs. The expense levels depend on the size and type of policy.

The way we charge for expenses also depends on the type of policy. For the personal pension plan we make an implicit allowance for expenses by reducing the *asset share* by the product charges applied to the policy. For other policies we make an explicit deduction from the *asset share* to cover expenses.

In each case the amount applied represents a fair proportion of the total expenses incurred in administering all policies, using generally accepted techniques.

Where a policy includes life cover we take the cost of this from the *asset share*.

## 11 What is working capital and how do you manage it?

So far we have only briefly mentioned the *working capital* of the fund but it plays a very important part in managing with profits business. Reading this section will help you to pull together the information we have provided in the previous sections.

As *Royal London* is a mutual society, the *working capital* of the fund is even more important as it represents the main source of capital that we have readily available to us to operate and develop the business to provide benefit to our *members* and other policyholders.

We decide how much *working capital* the fund should have and we use it to help us to manage the fund properly and support its operation. We use the *working capital* to make sure that we have enough money in the fund to satisfy our *regulator* (the Financial Services Authority), develop the business, issue new non profit and with profits policies and carry out *smoothing*, for example.

The *working capital* also gives us more freedom to invest the investments of the fund in company shares and property to provide higher growth over the long term. When the amount of *working capital* held is small we need to invest a higher proportion of the fund in more stable investments such as bonds or cash. Any exceptional costs which we decide should not be charged directly to with profits policyholders will be met from the *working capital*.

The *working capital* acts as a 'buffer' for with profits policies because it funds the business activities and receives the profits and losses on these activities instead of these being passed on directly to the with profits policies. We also use it to meet the cost of any guarantees and *smoothing* after taking off any charges made to policyholders for these.

We manage the size of the *working capital*. If at any time it is more than we think we need, we may decide to reduce it by distributing some of the profits, for example by enhancing *asset shares*, or by announcing increased bonuses. If we think that it is not enough, we may hold back some profits and instead announce reduced bonuses and/or take extra charges from *asset shares*.

The fund contains different groups of policyholders with different rights and interests in the fund including policies which were formerly with *Phoenix Life Assurance, Refuge Assurance, Scottish Life* and *United Friendly*. We aim to manage the fund to make sure that we treat all these different groups fairly.

## 12 How can I find out more?

Each June we report on how we have complied with the PPFM in the previous year and publish this on our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk)

We intend to publish on our website the investment mix for sample policies at 31 December each year. Your yearly statement will normally include information on the investment mix backing policies in your *sub-fund*.

If you need any more information or have any questions on this guide or the PPFM, please call us on 08450 502020 between 8am and 6pm Monday to Friday, except bank holidays.

If you would like a copy of this guide in large print, please call us on 08450 502020



### Royal London Group

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Royal London Group consists of The Royal London Mutual Insurance Society Limited and its subsidiaries. All of the following companies are authorised and regulated by the Financial Services Authority (FSA). The Royal London Mutual Insurance Society Limited (FSA registration number 117672) provides life assurance and pensions and is a member of the Association of British Insurers. Royal London Savings Limited (FSA registration number 191237) provides the Individual Savings Account. Royal London Unit Trust Managers Limited (FSA registration number 144037) provides unit trusts.

[www.royal-london.co.uk](http://www.royal-london.co.uk)