

Royal London with  
profits fund

# A guide to how we manage our with profits fund



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## 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.

The guide sets out our current approach. We might change the approach from time to time to respond to changing circumstances.

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 end of this guide.

## Who should read this guide?

You should read this guide if you have a Scottish Life branded with profits policy that was taken out after 30 June 2001. You should also read this guide if you have increased your premiums or paid additional single premiums to a Scottish Life with profits policy after 30 June 2001. This guide 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. This guide does not change the terms of your policy; it gives you further information to help you understand it better.

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

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# Principles and Practices of Financial Management

We manage the fund by following our Principles and Practices of Financial Management (PPFM).

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, the wording in the PPFM will apply.

We may change the Principles and Practices from time to time to respond to changing circumstances. If we make any changes we will publish them on our website. We will send you an updated copy of this guide if we make any significant changes.

You can obtain a copy of the current PPFM by visiting our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk).

## Our Guiding Principles

We will 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.

## 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.

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 on 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 out to shareholders.

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:

- the end of the policy term, as agreed when you started your policy (the maturity date) or
- when you retire (on your originally selected pension date) or
- the date of death if you were to 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 number of units in your policy gradually over the policy's lifetime by adding bonus units regularly. For some policy types we increase the value of each unit instead, but the effect is the same.

We may also pay a final bonus at the time 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, switching to another fund or taking early retirement, we may pay you less than the face value of units by applying a **market value reduction**.

More detail on the bonuses we pay, the market value reduction and how they are determined is contained in "How do you decide bonuses?" on page 8.

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

The amount we pay you is based 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 decide to cash in or switch some or all of the units in your policy or transfer it or take early retirement.

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.

We calculate **asset shares** by:

- looking at the premiums paid into the fund;
- making deductions to cover our expenses, tax (for life policies), the costs of providing benefits and guarantees to the policies;
- allowing for the investment returns earned by the investments backing the policy each 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 depending on the sub-fund the policy is in and then how long the policy has left to the end of the policy term. Your policy is invested in the **RL sub-fund**.

We also include any enhancements we have made.

We calculate **asset shares** for sample policies. These sample policies are chosen to be a good match for the full range of policies actually invested in the fund. The sample **asset share** calculations are performed 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.

Please note that **asset shares** are simply a measuring tool. We use the **asset shares** on sample policies to help us set bonus rates and we use **asset shares** in aggregate 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 for each sample policy.

If the **asset share** is higher than the value of units 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 we may apply a **market value reduction**.

We apply **smoothing** to the amounts we pay to make sure that you receive your fair share of the fund either at the end of your policy or on death.

We explain **smoothing** in "What is **smoothing** and how do you apply it?" on page 9.

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 policyholder receives in the future but only if the change is fair.

## How do you decide bonuses?

We usually announce bonus rates once a year. We may do this more often if we need to reduce the amounts we pay on claims to protect the interests of remaining policyholders, for example, if 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 number of with profits units used to calculate the value of your policy gradually over the policy's lifetime. Once added, the bonus units become part of the policy and cannot be taken away. However the face value of units and the regular bonus added may be reduced if you cash in your policy early, transfer your policy, switch to another fund or stop paying premiums early.

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 then we may decide not to announce a regular bonus. Similarly we may reduce the regular bonus where continuing with the previous rate might lead to guarantees at a level that unduly restricts investment freedom.

Different regular bonuses may be announced 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 not to change the amount of regular bonus we announce too much from year to year. To protect the fund in recent years we have announced regular bonuses at lower levels than they have been in the past.

### Interim bonuses

We may also pay an interim bonus on claims between regular bonus dates to make up for some or all of the expected regular bonus that may have been earned by the policy since the last regular bonus was announced. We determine interim bonuses in the same way as regular bonuses and there are situations when we might not pay any interim bonus.

### Final bonuses

We may also announce a final bonus. This is designed 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 **asset share** for sample policies with the face value of units. A scale of final bonuses is then determined after we have applied the appropriate **smoothing**. Some of these final bonuses may be zero, typically where the sample **asset share** is less than the value of units held.

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 decide to cash in or transfer your policy early or if you cash in or switch units or on other 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 including final bonus. If the sample **asset share** is less than the value of the units including final bonus then a **market value reduction** factor will be calculated.

We usually calculate these factors every month 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** factor 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.

## 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 bonuses in a way which 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.

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; and
- 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 and down, or we may decide not to allocate any bonus at all, they will usually be much more stable than the returns on the investments held by the fund.

Although we use it to reduce the impact of changes in investment returns, **smoothing** can't fully protect your investment. This is particularly the case following, for example, long periods of poor investment returns or sudden large market falls. When these happen we are likely to reduce final bonuses and payouts but still pay more than **asset share**.

We aim for the effect of **smoothing** to cancel itself out over the long term. This means that, over time, the amounts held 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** aims to protect the financial interests of all policyholders remaining in the fund. For policyholders who cash in their policy, transfer their policy, switch to another fund or stop paying premiums early, less **smoothing** is applied.

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

If you decide to cash in or switch some or all of the units allocated to your policy or to transfer your policy then 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 out less than the value of units and any final bonus added by applying a **market value reduction**. This is applied 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 to make an allowance for expenses we have incurred that we have not managed to recover 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%.

## 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 more stable investments where the return is guaranteed or less variable (for example government bonds).

Before 1 January 2010 we managed the fund as a single collection of assets. All policies invested 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 invested 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 in each sub-fund 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** for 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 reduced gradually the proportion in company shares and property to around 25% or lower and increased the proportion in government bonds, other bonds and cash.

We expect to publish the investment mix for sample policies at 31 December each year. For more information please visit our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk)

## 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 we sell 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 may use the **working capital** to invest in subsidiary companies of Royal London or other businesses with the aim of generating profits. The risk is that these investments may make lower profits than we expected or make losses.

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

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

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

We make an implicit allowance for expenses by reducing the **asset share** by the product charges applied to the policy.

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

We make a deduction from the **asset share** for the cost of the life cover where this is included in the policy.

## 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 should 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 to support its operation. We use the **working capital** to make sure that we have enough money in the fund to satisfy our regulator, 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. It is also used to meet the cost of any guarantees and **smoothing** after deducting any charges made to the with profits policyholders for these.

We manage the size of the **working capital**. If at any time it is more than we think we need then 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 then we may hold back some profits and instead announce reduced bonuses and/or make charges to **asset shares**.

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

## How can I find out more?

Each June we will 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).

If you need any more information or have any questions on this guide or the PPFM please call us on **08450 502020** between 8.00am and 6.00pm Monday to Friday, except bank holidays.

## Useful terms

### Asset share

Refers to the accumulation of premiums paid into a policy after deducting 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 enhancements to asset share.

### 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 invested 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 original pension date, or on death.

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

### Members

Members are policyholders who “own” Royal London. They are given rights to attend the Annual General Meeting and to vote. Some categories of with profits policyholder are not members, including policyholders whose policies were formerly with **Phoenix Life Assurance, Refuge Assurance, Scottish Life** or **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

### 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 term given to 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**.

### 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 Friendly

United Friendly Insurance Plc

### Unitised

The name given to a with profits policy such as yours where premiums have been used to buy units in a with profits fund.

### 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.

All literature about products that carry the Scottish Life brand is available in large print format on request to the Marketing Department. All our printed materials are 100% recycled, supporting responsible use of forest resource. Full details of Scottish Life branded products can also be obtained from the Marketing Department at Scottish Life, St Andrew House, 1 Thistle Street, Edinburgh, EH2 1DG.

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