

# 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.

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 beginning.

## Who should read this guide?

You should read this guide if you have an *Ordinary Branch conventional* with profits policy that was taken out with *Refuge Assurance* or *United Friendly* before 1 January 2001. It explains how we currently manage the *Royal London with profits fund* and how this affects your policy.

On our website we refer to this guide as Guide 2.

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. We also take off a *transfer to working capital*. From time to time we may also make adjustments to allow for any enhancements to *asset share*.

### Conventional

A type of with profits policy where payment of premiums guarantees an amount in the future.

### 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 either to a collector or, for *Refuge Assurance* policies, by standing order to a local branch office.

### 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* 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 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.

### 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 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 [www.royallondongroup.co.uk](http://www.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. In return for the premiums that you promise to pay us, we will promise to pay you a guaranteed amount. We add bonuses to this guaranteed amount to form the total payment that you may expect to receive from your policy.

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.

As your policy was taken out with *Refuge Assurance* or *United Friendly* 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 guaranteed amount

The guaranteed amount we promise to pay you may be:

- one lump sum payment (a sum assured)
- a series of payments (a pension).

We will pay the guaranteed amount on the set event or date in your policy schedule. If the guaranteed amount is a series of payments, we will pay the first of the series 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)
- when you take your pension benefits at your 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 guarantee to pay you a minimum amount. Please refer to your policy documents for details.

### The bonuses

We aim to increase the guaranteed amount by adding annual bonuses throughout your policy's term. We normally add annual bonuses every year. We may also pay interim bonuses on claims between annual bonus dates.

We may also pay a final bonus when we pay you the guaranteed amount and annual bonuses. If you cash in or transfer your policy or stop paying premiums early we may pay you a reduced amount of the bonuses you would have received had you kept your policy until the end of its term.

There are more details on the bonuses we pay in section 5 – 'How do you decide bonuses?'

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

The amount we pay you is made up of a guaranteed amount plus any annual bonuses we have added to your policy. We may also pay you a final bonus.

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 on the set event or date in your policy schedule.

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), the cost of providing benefits and guarantees to the policies and a *transfer to working capital*.
- Then we allow 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 according to the *sub-fund* the policy is in and how long the policy has left until the end of the policy term.

We also include any enhancements we have made.

We calculate *asset shares* for sample policies. We choose these sample policies to be a good match for the full range of policies actually in the fund. We perform the sample *asset shares* calculations so that we can keep track of the relationship between the amounts we pay you and the investments available in the *sub-fund* for your policy. 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.

For the group of policies that best represents your policy we compare the sample *asset shares* with the guaranteed amount and annual bonuses that we have already promised to pay you. We will pay you at least the guaranteed amount providing you have paid all the premiums due under your policy.

If the *asset share* is higher than the amount we have already promised, 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 we pay.

We apply *smoothing* to the amounts we pay over and above the guaranteed amount to make sure that 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 80% to 140%.

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 bonuses once a year. We may do this more often 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.

### Annual bonuses

We announce annual bonuses that increase the guaranteed amount of your policy gradually over the policy's lifetime. Once added, an annual bonus becomes part of the guaranteed amount and cannot be taken away. However the guaranteed amount and the annual bonus added will probably be reduced if you cash in or transfer your policy or stop paying premiums early.

We decide annual 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 economic and investment conditions and the outlook for the future.

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

We may announce different annual 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 or policies with different guaranteed amounts).

We try not to change the amount of annual bonus we announce too much from year to year.

To protect the fund in recent years we have announced annual bonuses that are lower than they have been in the past.

## Interim bonuses

We may also pay an interim bonus on claims on policies taken out with *Refuge Assurance* between annual bonus dates to make up for some or all of the expected annual bonus that the policy may have earned since we announced the last annual bonus. We determine interim bonuses in the same way as annual bonuses and there are situations when we might not pay any interim bonus.

## Final bonuses

We may also announce a final bonus. We do this to increase what you get back from your policy if the annual 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.

For the group of policies that best represents your policy we compare the *asset share* for sample policies with the guaranteed amounts. We determine a scale of final bonuses after we have applied the appropriate *smoothing*.

Some of these final bonuses may be zero, typically where the sample *asset shares* are less than the guaranteed amounts.

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.

We may announce final bonuses more often than once a year to make sure every policyholder receives their fair share of the fund.

Final bonuses are NOT guaranteed in any circumstances.

## 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 take into account 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 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 annual bonus we should announce and how much this bonus will cost
- look at how the payouts on recently maturing policies compare with their *asset shares* and whether they are bigger or smaller.

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.

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 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 or where we stop receiving premiums early, but not as much.

For historic reasons some *Refuge Assurance* policyholders are receiving enhanced payouts that are above the *asset shares* of those groups of policies.

The over-riding aim of our *smoothing* policy is to ensure that all policyholders receive their fair share of the fund.

## 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 or transfer your policy or stop paying premiums early, we need to work out how much to pay you in order to be fair to you and to those remaining in the fund.

Policyholders who cash in or transfer their policies or stop paying premiums early will not pay all the premiums they agreed when they started their policies. We must take account of this premium shortfall and of the fact that we will be paying a lump sum earlier than we had planned.

Payments when you cash in or transfer your policy or stop paying premiums early will normally be less than guaranteed amounts. This is to protect remaining policyholders and allow for expenses we have incurred that we have not managed to cover out of the premiums already paid.

We will calculate payments in these circumstances, or following any alteration to the original guaranteed amount, using methods which allow for our expenses and the early payment of the guaranteed amount. We may change these methods from time to time to ensure fairness to all policyholders.

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

The range in which we aim to target most payments when you cash in or transfer your policy, or stop paying premiums, as a percentage of *asset share* is 70% to 140% for policies taken out with *Refuge Assurance* and 70% to 140% for policies taken out with *United Friendly*.

## 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. The asset mix in each *sub-fund* may be different as it will depend on the mix of policies in the *sub-fund* and how long the policies have until they reach the end of their term. Your policy is in the *RLOB sub-fund* (*Refuge Assurance* policies) or the *UFOB sub-fund* (*United Friendly* policies).

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 by each *sub-fund*. 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.

From 1 January 2010 the investment mix underlying *asset shares* is different for each *sub-fund* and varies according to the mix of policies in the *sub-fund*.

## RL sub-fund

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.

*Refuge Assurance* regular premium pension policies taken out before 1 October 1992 and single premium pension policies are now invested entirely in government bonds, other bonds and cash.

## UFOB sub-fund

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 35% 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.

Certain *United Friendly* pension policies are now invested entirely in government bonds, other bonds and cash.

## 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 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 in 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 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 with profits policies covered in this guide do not have explicit charges. Instead, we take account of the expenses of administering the policies and other charges when we decide the bonuses.

The expenses we charge to *asset shares* broadly cover the set up costs, any commissions paid, ongoing administration costs and investment management costs. The expense levels depend on the size and type of policy.

We take off the cost of risk benefits from the *asset shares* where these are included in the policy. Examples of 'risk benefits' are life cover (payments on death) or terminal illness cover (payments on diagnosis of a serious life threatening illness).

We may make a charge to *asset share* to cover the cost of paying guaranteed amounts (for example the guaranteed sum assured plus annual bonuses we have already announced). We would determine this cost using generally accepted techniques.

Currently we make no charges for guaranteed amounts on any policies covered in this guide.

## 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 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.

As a result of the transfer of the *Ordinary Branch* policies of *United Friendly* it was agreed that this group would have its own separate *working capital* to be used to manage the policies in this group and to be distributed to them over time. These policies also share in the *working capital* of *Royal London*.

## 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 in the *sub-funds* 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



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Royal London Plus is a division of The Royal London Mutual Insurance Society Limited. The Royal London Mutual Insurance Society Limited provides life assurance and pensions, is authorised and regulated by the Financial Services Authority (registration number 117672) and is a member of the Association of British Insurers and the Association of Financial Mutuals.

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