

**Principles and Practices of
Financial Management**

**Royal London Long Term Fund
excluding
The Scottish Life Closed Fund and
the PLAL With-Profits Sub-fund**

**Report to with profits policyholders
on compliance for 2009**

June 2010

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1. Introduction

On 30 April 2004 The Royal London Mutual Insurance Society Limited ('Royal London') first published its Principles and Practices of Financial Management ('PPFM') for the Royal London Long Term Fund (excluding the Scottish Life Fund). An updated version of the PPFM for the Royal London Long Term Fund (excluding the Scottish Life Fund and the PLAL With-Profits Sub-fund) was published on 31 December 2009 and a further updated version was published on 29 April 2010.

This report gives information on how the PPFM was complied with during 2009.

The directors must provide a report each year to with profits policyholders giving information on how they have complied with the PPFM. The directors have reviewed the operation of the fund for the period 1 January 2009 to 31 December 2009 and in their opinion the management of the with profits business in the fund over this period has complied with the PPFM in all material respects. It is also their opinion that the exercise of discretion over the period was appropriate and that any issues involving competing or conflicting rights, interests and expectations of policyholders were resolved fairly.

In coming to this view the directors have taken account of internal and external professional advice provided during the year, including advice from the With Profits Actuary and the Actuarial Function Holder. This report sets out the main reasons for the directors' opinion and the following sections consider, in turn, governance, the exercise of discretion, competing and conflicting interests, and compliance with the PPFM.

2. Governance

Appropriate governance arrangements to monitor compliance with the PPFM have operated throughout the period in question. This includes input as appropriate from the With Profits Actuary, from the Actuarial Function Holder and from the Independent Person who was appointed by the directors to provide an external independent assessment on compliance with the PPFM, to provide advice on the way the fund is managed and to provide an independent view when the directors are considering any issues which involve competing or conflicting rights and interests of policyholders.

Opinion from the external auditors has also been obtained where required, as part of their annual audit.

The With Profits Actuary and the Independent Person have each provided detailed reports to the directors which confirmed, following appropriate investigation, that over the period under consideration, in their opinion the with profits business has been managed in line with the relevant PPFM in all material respects.

A short report to policyholders from the With Profits Actuary confirming his view is attached.

3. Exercise of discretion

The main areas in which discretion is exercised in the operation of with profits business are setting bonus rates, investment strategy, setting surrender values and the management of the estate.

Setting bonus rates

For conventional contracts, the only changes in annual bonus rates in the period took place as a result of the declaration of the annual and interim bonus as at end 2008. The exceptionally difficult conditions experienced in the second half of 2008 and early 2009 led to more frequent reviews of final bonuses during 2009. Final bonus rates were changed on 1 January, 1 April, 1 May and 1 October.

For unitised contracts, regular reviews of final bonus were carried out and the more frequent reviews continued during 2009 in response to the difficult conditions. Changes to final bonus rates were made as appropriate in accordance with the PPFM.

The directors took into account advice from the With Profits Actuary and the Actuarial Function Holder in making these changes to final bonus rates.

The main bonus investigation in respect of 2009 led to a declaration in respect of annual bonus on 29 March 2010. The directors took into account advice from the With Profits Actuary and the Actuarial Function Holder and complied with the PPFM.

Investment strategy

During the continuing difficult market conditions in the first quarter of 2009 the assets and the level of capital were monitored closely, and a reduction in the amount of equities was made as part of the ongoing management actions in response to the market turmoil.

During 2009 a new investment strategy was developed and, after detailed consideration, approved by the directors, to take effect from 1 January 2010. In preparation for the new strategy some rebalancing of investments between the different sub-funds took place during December 2009 and the sale of some equities took place.

Setting of surrender values

For unitised contracts the normal regular reviews of market value reduction (MVR) factors were carried out. In addition the more frequent reviews continued during 2009 in response to the difficult conditions. Changes to MVR factors were made as appropriate in accordance with the PPFM.

Changes to surrender bases for certain conventional with profits contracts were implemented during 2009 so that surrender payouts were better aligned with asset shares.

Management of the estate

The methods of monitoring and managing the estate and the additional accounts of the closed sub-funds were further developed and clarified during 2009.

Changes to PPFM

Changes have been made to several of the Practices and updated versions of the PPFM were published on 31 December 2009. All changes to the PPFM were approved by the directors.

The main changes made to the Practices were:

- to clarify the approach to be adopted with respect to the management of the estate
- to better describe the operation of the additional accounts associated with the UFIB, RAIB and UFOB sub-funds.

- to update the investment strategy section and make consequential changes to the section on calculation of asset shares to reflect the new investment strategy from 1 January 2010
- to update the policy benefits payable section to explain that payouts for policies in the UF OB sub-fund were unlikely to be targeted above 100% asset share for the foreseeable future.
- to update the target ranges for payouts for conventional with profits policies.

Other minor changes to the wording were made in various sections and the glossary was updated.

A document setting out a summary of the changes to the PPFM was published on 31 December 2009 on www.royallondongroup.co.uk .

4. Competing or conflicting rights, interests and expectations

In any with profits fund, different groups of policyholders could have competing or conflicting interests. For example, holders of

- policies of different types (such as life or pension policies or regular or single premium)
- policies of different sizes or different policy terms
- policies which started in different years or mature in different years

or policyholders

- of different ages
- claiming for different reasons (for example maturity, death, surrender)
- exercising different policy options

could receive different benefits relative to each other depending on how discretion is exercised.

The main areas in which judgement and discretion are exercised in balancing the interests of the various groups of policyholders are in the smoothing of policy benefits, the grouping of policies for calculating asset shares and hence setting bonus rates and surrender values and with respect to the practices for managing the estate and for distributing the additional accounts of the closed sub-funds.

Any conflicts which have arisen have been appropriately and fairly resolved, in the directors' opinion, after taking expert advice, where necessary.

5. Compliance with PPFM

Management of the estate

The directors were provided during 2009 with information and actuarial reports on a regular basis regarding the current and projected financial position of the fund. The capital position of the fund was monitored closely in response to the very difficult investment conditions in the first half of the year. The methods of monitoring and managing the estate were further developed and clarified during 2009.

The recovery of the investment markets during the second half of 2009 enabled the directors to allocate a 'mutual dividend' in respect of 2009.

In line with the requirement to distribute the additional account over the lifetime of the

remaining policies, the directors again targeted payouts on a value in excess of asset share for UFIB and RAIB policies. In addition, enhancements to asset shares were made for policies in these sub funds as part of the end 2009 bonus declaration.

Business activities

No change has been made to the level of subordinated debt raised in November 2005 which remains at £400m.

New business volumes

No specific volume limitations were deemed necessary on new business, whether with profits or non profit business. The volume of new business and the mix of new business was regularly monitored throughout the year against the planned volume and business mix.

Investment strategy

During 2009 the Capital Management Committee met 8 times. Technical papers on investment strategy were presented during the year and advice from the With Profits Actuary and the Actuarial Function Holder was obtained where appropriate.

The performance of the investment manager was monitored by the Capital Management Committee and the directors. Changes to benchmarks were approved by the directors.

Policy benefits payable

Bonus reports presented to the directors provided evidence that the methodology used to set bonuses and policy benefits followed the approach set out in the PPFM, including the more frequent reviews during 2009.

The bonus rates declared differed between product types and classes. The bonus report made specific reference to compliance with schemes of transfer where appropriate and demonstrated how the competing interests of Royal London policyholders, and policyholders whose policies were transferred to Royal London under a scheme of transfer, were being addressed.

The size of the Additional Accounts for RAIB and UFIB and the requirement to distribute these accounts over the lifetimes of the policies led the directors to take action to distribute the Additional Accounts by approving final bonus scales at levels such that payments in excess of asset share would be made during 2009 for RAIB and UFIB maturing policies.

Actuarial reports on reviews of proposed changes to surrender value bases, including changes to market value reduction factors (MVRs) had regard to the PPFM and commented where appropriate on fairness of treatment and how any conflicting interests had been taken into account.

An exercise to review compliance with the target ranges for maturity and surrender payouts published in the PPFM was carried out. This demonstrated compliance with the target ranges for most policy groups. However, the PPFM explains that the target range may not apply in extreme adverse conditions. The surrender values of some policies within the UFOB sub-fund had been reduced during the exceptionally poor investment conditions in the first part of 2009 in order to better align them with the lower levels of asset shares and to preserve the financial strength of the sub-fund. The target ranges had been moved upwards for 2009, in response to the falls in equity markets at the end of 2008. The strong and rapid recovery in the market in the second half of 2009 therefore led to more than 10% of the surrender claims for these types of policy falling outside the target range. Appropriate action to address this issue was approved by the directors.

6. Conclusion

In the opinion of the directors, the management of the with profits business in the fund over this period has complied with the PPFM in all material respects. It is also their opinion that the exercise of discretion over the period was appropriate and that any issues involving competing or conflicting rights, interests and expectations of policyholders were resolved fairly.

M J Yardley
Group Chief Executive
1 June 2010

Report from the With Profits Actuary

To with profits policyholders in the Royal London Long Term Fund, excluding the Scottish Life Closed Fund and the PLAL With-Profits Sub-fund

In my opinion the discretion exercised by the directors in respect of the period covered by their report has taken policyholders' interests into account in a reasonable and proportionate manner. It is also my opinion that the directors have complied with the requirements of the Principles and Practices of Financial Management (PPFM) of the Royal London Long Term Fund (excluding the Scottish Life Closed Fund and the PLAL With-Profits Sub-fund).

I have based these opinions on the information and explanations provided to me by the directors and management of Royal London and in doing so I have taken into account the relevant rules and guidance of the Financial Services Authority, of the Board for Actuarial Standards and of the Actuarial Profession regarding the management of with profits business.

Separate reports confirm compliance in respect of the Scottish Life Closed Fund and in respect of the PLAL With-Profits Sub-fund.

S Wilson BSc FIA
With Profits Actuary
1 June 2010