

**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 2010**

**June 2011**

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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 further updated versions were published on 29 April 2010 and 31 December 2010.

This report gives information on how the PPFM was complied with during 2010.

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 2010 to 31 December 2010 and in their opinion the management of the with profits business in the fund over this period has, other than in two respects outlined below, 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 to them 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 directors concluded that the with profits business has been managed in line with the relevant PPFM in all material respects, other than in two particular aspects following advice from the With-Profits Actuary and the Independent Person.

The first aspect was a conscious decision by the directors to target payouts in excess of asset share to recognise the strength of the fund. This decision was taken following advice from the With Profits Actuary and the Independent Person.

The second aspect was a decision temporarily to suspend reviews of final bonus rates and MVRs on some unitised with profits business. This was done to allow system updates following the new investment strategy, introducing hypothecation and lifestyling, which was implemented at the end of 2009 and communicated to policyholders in early 2010. The clear

intention was that after the system updates had been completed any additional payments that were due would be made to policyholders who had exited. Arrangements have been put in place for the additional payments to be made to ensure there is no policyholder detriment as a result.

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, allocation of expenses, management of the estate and management of risks.

#### *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 2009. The increased frequency of final bonus reviews that was adopted in 2009 continued through 2010. Final bonus rates were changed on 1 January, 1 April, 1 May and 1 October.

As noted above, for some unitised contracts, regular reviews of final bonus were temporarily suspended during 2010 to accommodate system changes. As was intended, arrangements have been put in place to correct any underpayments to exiting policyholders that resulted from this suspension to ensure there is no policyholder detriment as a result.

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

The main bonus investigation in respect of 2010 led to a declaration in respect of annual bonus on 22 March 2011. The directors took into account advice from the With Profits Actuary and the Actuarial Function Holder and complied with the PPFM. The directors also took account of advice from the Independent Person in reaching their decision.

#### *Investment strategy*

The new hypothecation and lifestyling investment strategies that were developed in 2009 were put into effect from 1 January 2010. The introduction of these investment strategies has significantly reduced the risk of capital being required from the open fund to support the closed funds. An extensive mailing exercise was carried out to inform policyholders of the change to investment strategy. There have been no major changes to the asset allocation over the course of 2010.

The aim of the investment strategy remains to maximise the long term return on investments for with profits policyholders whilst recognising the need for the fund to meet its guaranteed liabilities and commitments to policyholders and maintaining the estate at the target size.

A common statistic used to categorise the level of investment risk within a fund is the proportion of the fund's assets that are invested in equity and property. The overall proportion in each of the sub-funds at the end of 2010 is set out in the following table:

Royal London Open Fund	Open	53%
United Friendly OB	Closed	30%
United Friendly IB	Closed	53%
Refuge IB	Closed	37%

The effect of lifestyling within each of these funds is to reduce the proportion of equity and property backing an individual policy as that policy approaches its maturity date. Within the Open fund at the end of 2010 the proportion in equity and property varied, depending on the term to maturity, as follows:

Term to Maturity (years)	Proportion in Equity and Property
15	67%
10	63%
5	42%
1	35%

#### *Setting of surrender values*

As noted above, for some unitised contracts the normal regular reviews of market value reduction (MVR) factors were temporarily suspended during 2010.

Changes to surrender bases for certain conventional with profits contracts were implemented during 2010 so that surrender payouts were better aligned with asset shares.

#### *Allocation of expenses*

For policies that are not covered by expense agreements as part of previous schemes of transfer our aim is to allocate expenses to policies that correspond to the expenses incurred. Over the course of 2010 the expenses allocated to with-profits policies were compared to the actual costs of administering those policies. The expenses allocated to with-profits policies were confirmed as being appropriate and in line with the PPFM.

#### *Management of the estate*

The existing methods of monitoring and managing the estate and the additional accounts of the closed sub-funds were maintained throughout 2010.

#### *Management of risk*

Royal London continuously seeks to obtain independent assurance that its systems of risk management and internal control are operating effectively. In addition we obtain independent

opinions on the effectiveness of the key systems and controls throughout the organisation. This includes evaluating the effectiveness of, and the adequacy of, the risk management processes and ensuring compliance with policies and procedure. The effectiveness of internal control and the risk management infrastructure is also specifically considered by our external auditors in the context of their review of our financial statements.

We have developed a number of actions to mitigate the business risks that are run within the fund including exposures to investment, expense, mortality, morbidity and lapse risks.

#### *Changes to PPFM*

Minor changes have been made to the Practices and updated versions of the PPFM were published on 29 April 2010 and 31 December 2010. All changes to the PPFM were approved by the directors.

The main changes made to the Practices were:

- to clarify the practices relating to the calculation of payments on voluntary exit of conventional with profits policies,
- to reflect the improved strength of the UF OB fund in the sections on Management of the Estate and Policy Benefits Payable,
- to clarify the section on Investment Strategy, and
- 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. In addition the document was brought into line with the Royal London 'Financial Sense' branding.

Summaries of the changes to the PPFM were published on 29 April 2010 and 31 December 2010 on [www.royallondongroup.co.uk](http://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.

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 2010 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. The methods of monitoring and managing the estate were maintained throughout 2010.

The continued recovery of the investment markets and strong operating profits during the year enabled the directors to allocate a 'mutual dividend' of £85m in respect of 2010.

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 2010 bonus declaration. The improved position of the UFOB fund also allowed payouts to be targeted above asset share.

### *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 and mix of new business was regularly monitored throughout the year against the planned volume and business mix. The profitability of new business was also monitored regularly throughout the year, to ensure that there was no detriment to the interest of with profits policyholders.

### *Investment strategy*

During 2010 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 2010.

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, UFIB and UFOB 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 2010 for RAIB, UFIB and UFOB maturing policies.

Actuarial reports on reviews of proposed changes to surrender value bases 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 all policy groups.

## 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, with two exceptions as noted above. The directors do not believe that either of the exceptions involved any disadvantage to policyholders. 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

10 June 2011

## 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) in all material respects, with two exceptions. Neither of the two exceptions will result in any policyholder detriment.

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  
10 June 2011