

# Notification of changes

## to the Principles and Practices of Financial Management of the Royal London Long Term Fund

### Introduction

In December 2009 we published an updated version of our Principles and Practices of Financial Management (PPFM). This replaced the PPFM published in December 2008.

This leaflet summarises the changes we have made to the PPFM since December 2008. It does not form part of the PPFM but is simply to keep you informed and comply with Financial Services Authority rules. You do not need to do anything.

If you would like a copy of the PPFM, you can download it from our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk) or you can ask us to send you one by calling us on 08450 502020.

### Changes to the Principles

We have made no changes to the Principles.

### Changes to the Practices

The main changes we have made are in the following sections.

#### 2.3 Management of the Estate

We have amended this section to permit clarification of how we manage the estate, including more explanation of the operation of the Additional Accounts associated with the UFIB, RAIB and UFOB sub-funds. The revised practices are set out in full below.

As a mutual RL uses its Estate to enable it to

- meet the reasonable benefit expectations of existing policyholders
- invest in a mix of assets designed to maximise long term returns to the fund whilst ensuring solvency
- write new with profits and non-participating business
- operate the smoothing and distribution policy
- develop the business of RL
- meet its Regulatory Capital Resource Requirements in all reasonably foreseeable circumstances.

The target level of the Estate is determined as the sum of a multiple of the Individual Capital Assessment (ICA) and further amounts determined by the Directors as appropriate taking into account the uses of the Estate and the Directors' attitude to the risk of failing to meet its Regulatory Capital Resource Requirements.

The level of the Estate is assessed and managed appropriately with the aim of maintaining it, where possible, within an agreed range around the target level determined by the Directors.

The target level of the Estate will be reviewed by the Directors, normally annually, and may be changed following Actuarial Advice to reflect for example changes in economic conditions, changes in regulatory requirements or expectations and changes in the Directors' risk appetite.

RL aims to distribute each Additional Account to the policies in that sub-fund over the lifetime of those policies. The target level of each Additional Account is determined as the sum of the Individual Capital Assessment (ICA) for that sub-fund and further amounts determined by the Directors as appropriate. The level of each Additional Account is assessed and managed appropriately with the aim of maintaining it, where possible, within an agreed range around the target level determined by the Directors. In recent years the UFOB Additional Account has been below the target level and this is expected to continue.

Different target levels and agreed ranges around the target level may be set for the Estate and each Additional Account.

Regular reports, normally monthly, are provided to the Capital Management Committee and the Directors to enable them to monitor the level of the Estate and each Additional Account in relation to the target levels, the range around the target and the likelihood of the level of the Estate or Additional Account moving outside its range.

As a result of the information provided in the regular reports the Capital Management Committee makes recommendations to the Directors, with the agreement of the Group Chief Executive Officer, on any investment-related action required to steer the level of the Estate or Additional Account towards the agreed target.

Other reports provided include estimates of the level of free assets and half yearly results of investigations into the robustness of the Estate and each Additional Account to different economic and investment scenarios.

The level of the Estate and each Additional Account is managed appropriately by the Directors upon receiving Actuarial Advice. If the size of the Estate or Additional Account is outside the range around the target level they may authorise an increase or reduction in the level of the Estate or Additional Account by changing as necessary the investment strategy, bonus strategy, payout strategy or smoothing strategy as described in the later sections in this document in order to maintain fair treatment of policyholders. Any action which the Directors may decide to take will depend on factors including the reasons for and extent to which the Estate or Additional Account is above or below the target level, whether the situation is expected to be temporary or longer lasting, and an assessment of the impact of a range of appropriate actions. The Directors will obtain Actuarial Advice when assessing the range of potential actions.

In assessing the appropriate level of the Estate for the purpose of determining whether there is any excess surplus which should be distributed, the Directors will take

into account that as a mutual the Estate is the primary source of capital to support the business and their desire to provide sufficient investment flexibility in order to maintain the investment strategy in line with expectations of existing policyholders.

The Estate is meeting or being credited with the differences between

- the expenses of administering with profits and non-participating policies and the administration charges passed on to such policies
- the cost of risk benefits and the charges for risk benefits passed on to with profits and non-participating policies
- the cost of guarantees on with profits and non-participating policies and the charges made for those guarantees
- the cost of smoothing for with profits policies and charges made to with profits policies for the smoothing.

The Estate is being used to meet

- the expenses of management of certain classes of with profits policy where the expense levels are higher than those charged to policyholders
- the cost of those annuity guarantees which are not charged to policyholders
- the cost of redress or guarantees on mortgage endowment policies.

The Estate is being used to provide capital to write new with profits and non-participating business.

The Estate is being credited with one-ninth of distributed surplus each year on certain transferred with profits policies from UAG. This transfer is the same transfer that

was previously made to shareholders of UAG. The right to this transfer was purchased by Royal London when it acquired the shares of UAG and was set out in the UAG Scheme of Transfer.

The Estate may be required to meet any strains arising in respect of certain transferred with profits policies from UAG if the Additional Account for the business concerned is unable to meet such costs. The Estate may be used to meet any shortfall arising out of transferred business in the SL Closed Fund. The Additional Account of UF OB is entitled to receive distributions of miscellaneous surplus from the Estate in accordance with the terms of the UAG Scheme of Transfer. Currently there are no shortfalls requiring support.

The Estate contains strategic investments which are identified in the later section in this document under Investment Strategy and therefore the investment strategy of the Estate is generally different from that of the rest of the fund.

## 2.4 Business Activities

For clarity we have added a further example of a risk and the mitigation of that risk.

### Risk

Financial support may be required to meet any shortfalls in any of the closed sub-funds (UF IB, RA IB, UF OB, the SL Closed Fund and the PLAL With-Profits Sub-fund). This may reduce any distribution from the Estate which could otherwise have been made to asset shares.

### Mitigation

Monitoring the size of and managing the Additional Accounts, the SL Closed Fund and the PLAL With-Profits Sub-fund to minimise the risk of a shortfall arising.

We have also added some wording to clarify that IB policies in Group D do not participate in the rewards or losses from the estate.

The rewards or losses from business risks are credited or charged to the Estate, and there is no specific limit on the amount that is credited or charged. There is no direct impact on policy benefits in Groups A, B, C, E, F and UF OB policies in Group D payable other than as a result of distribution from the Estate or the need to increase the level of the Estate. IB policies in Group D do not participate in the rewards or losses credited to the Estate as they instead participate in distribution of the relevant Additional Account.

## 2.6 Investment Strategy

We have changed the investment strategy and a new practice has been added to explain the change. There are also some consequential changes to the wording of later practices in this section to reflect the change.

Before 1 January 2010 the fund was managed as one pool of assets. From 1 January 2010 the fund is managed as four separate pools of assets, backing four liability pools (UF IB, RA IB, UF OB and the remainder of the business in the fund), each of which may have a different investment strategy appropriate for the business in that pool as described below. For each asset pool we aim to maximise the returns in that pool subject to the mix of policies and after taking into account the size of the Estate or Additional Account as appropriate.

- (1) policies in Groups A, B, C, E and F

The unit linked business in this pool is backed by appropriate matching linked assets. Other non-participating business and the

asset shares of specified classes of with profits policies with significant guarantees are backed by solely by cash and fixed interest assets of appropriate term. The asset mix underlying the asset shares of the remaining with profits policies within the pool varies according to the duration of policies within the pool. For individual policies the proportion deemed to be invested in cash and fixed interest assets increases as the policies approach their maturity date. The asset mix for the Estate is determined after consideration of the value of the Estate relative to its target size and to the Regulatory Capital Resource Requirements.

- (2) UF IB policies in Group D
- (3) RAIB policies in Group D
- (4) UFOB policies in Group D

The asset mix underlying the asset shares of with profits policies within each of the above pools varies according to the mix of policies within the pool and on the size of the Additional Account relative to its target size. For individual policies in the pool, the proportion deemed to be invested in cash and fixed interest assets increases as the policies approach their maturity date.

The Directors set benchmarks for the asset allocations of the four asset pools within the fund. Currently the strategy and the asset mix are reviewed quarterly by the Directors but these may be changed more frequently or at any time in order to reflect changes in circumstances. The investment mix of each pool is monitored by the Capital Management Committee, which normally meets every two months or more frequently if market conditions dictate. Changes to the benchmark asset allocations are

recommended to the Group Chief Executive Officer by the Capital Management Committee upon receiving Actuarial Advice. Significant changes to the benchmark allocations require approval by the Directors upon receiving Actuarial Advice.

### 2.7.1 Policy Benefits Payable

We have added some wording to clarify the position for UF IB, RA IB and UF OB policies.

UF IB and RA IB policies in Group D may target maturity payouts as a greater percentage of enhanced asset share in order to distribute the relevant Additional Account over the lifetime of the business in force.

The UF OB policies in Group D may target maturity payouts as a greater percentage of enhanced asset share in order to distribute the Additional Account over the lifetime of the business in force. However the UF OB sub-fund is currently weak and payouts are unlikely to be targeted above 100% of enhanced asset share for the foreseeable future.

We have updated the target ranges for payouts on conventional business as a proportion of asset share to 80% to 140% for maturities and 70% to 140% for surrenders for groups A, D and F. The target ranges for unitised business are unchanged at 75% to 125% for maturities and surrenders.

### 2.7.2 Calculation of Asset Shares

We have made changes to the description of the investment returns added to the asset shares to reflect the revised investment strategy. The relevant revised practices are set out below for each policy group.

**Group A (Conventional with profits policies issued by RL before 1 January 2001)**

INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account when calculating asset shares was that achieved on the pool of assets deemed to back the with profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the investment return allocated to asset shares is based on the asset mix assumed to back the asset shares of the with profits policies in the investment pool for this group. The asset mix and therefore the investment return to be allocated to asset shares varies depending on the policy type and the period to the maturity date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as the maturity date approaches.

**Group B (Unitised with profits policies issued by RL)**

INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account when calculating asset shares was that achieved on the pool of assets deemed to back the with profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the investment return allocated to asset shares is based on the asset mix assumed to back the asset shares of the with profits policies in the investment pool for this group. The asset mix and therefore the investment return to be allocated to asset shares varies depending on the policy type and the period to the maturity date or expected claim date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as the maturity date or expected claim date approaches.

**Group C (with profits benefits of Scottish Life branded policies issued after 30 June 2001)**

INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account when calculating asset shares was that achieved on the pool of assets deemed to back the with profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the investment return allocated to asset shares is based on the asset mix assumed to back the asset shares of the with profits policies in the investment pool for this group. The asset mix and therefore the investment return to be allocated to asset shares varies depending on the policy type and the period to the maturity date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as the maturity date approaches.

**Group D (Conventional OB and IB with profits policies issued by UF and conventional IB with profits policies issued by RA)**

INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account in recent years when calculating asset shares was that achieved on the pool of assets deemed to back the with profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the UF IB, RA IB and UF OB policies are invested in separate asset pools. The investment return allocated to asset shares for each policy group is based on the asset mix assumed to back the asset shares of the with profits policies in each pool. The asset mix and therefore the investment return to be allocated to asset shares to each group of policies varies depending on the policy type and the period to the maturity date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as the maturity date approaches. Certain UF OB pension policies are deemed to be invested wholly in fixed interest securities and cash from 2010 onwards.

**Group E (Unitised with profits policies issued by RA before 1 January 2001)**

INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account in recent years when calculating asset shares was that achieved on the pool of assets deemed to back the with

profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the investment return allocated to asset shares is based on the asset mix assumed to back the asset shares of the with profits policies in the investment pool for this group. The asset mix and therefore the investment return to be allocated to asset shares varies depending on the period to the maturity date, guarantee date or assumed claim date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as this date approaches.

#### **Group F (Conventional OB with profits policies issued by RA before 1 January 2001)**

##### INVESTMENT RETURNS

For calendar years up to and including 2009 the investment return taken into account when calculating asset shares was that achieved on the pool of assets deemed to back the with profits business i.e. the fund excluding the assets held to support non-participating business and the Estate but may include the return on strategic investments. All with profits policies in the fund received the same investment return.

For 2010 and subsequent years the investment return allocated to asset shares is based on the asset mix assumed to back the asset shares of the with profits policies in the investment pool for this group. The

asset mix and therefore the investment return to be allocated to asset shares also varies depending on the policy type and the period to the maturity date. Generally the proportion deemed to be invested in cash and fixed interest assets will increase as the maturity date approaches. Regular premium pension policies issued before 1 October 1992 and single premium pension policies are deemed to be invested wholly in fixed interest securities and cash from 2010 onwards.

#### **2.7.3 Smoothing**

We have updated the tables showing changes in payouts.

#### **Other changes**

We have updated some other sentences throughout the PPFM to aid clarity and updated the Glossary.

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



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