

**Principles and Practices of  
Financial Management**

**The Scottish Life Closed Fund**

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

**June 2010**

CONTENTS	Page
1. Introduction.....	3
2. Governance.....	3
3. Exercise of discretion.....	3
4. Competing or conflicting rights, interests and expectations...	5
5. Compliance with PPFM.....	5
6. Conclusion.....	6
Report from the With Profits Actuary.....	7

## 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 Scottish Life Closed Fund ('the fund'). The most recent version was published on 31 December 2009.

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.

The Supervisory Committee which monitors that the fund is managed in accordance with the terms of the scheme of transfer of business from Scottish Life to Royal London was in operation during the period. The Committee has not raised any concerns about the way the fund is being managed and operated.

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 all contracts, bonus rate changes in the period took place as a result of the declaration of the annual bonus, interim bonus and final bonus rates as at end 2008.

Mid term reviews of final bonus rates were carried out and final bonus rates were changed on 1 April, 1 July and 1 October.

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

The main bonus investigation for 2009 led to a declaration in respect of annual bonus on 29 March 2010. In recognition of the improved financial position of the fund a demutualisation enhancement of 0.7% was made to the asset shares of qualifying with profits policies in respect of 2009. In addition, with effect from 1 January 2010 payouts will be targeted at above 100% asset share. In making this declaration the directors took into account advice from the With Profits Actuary and the Actuarial Function Holder and followed the requirements of the PPFM.

#### *Investment strategy*

During 2009, in order to reduce risk and to increase security for with profits policyholders the directors deemed it appropriate to continue to slightly reduce the proportion invested in equities and property and increase the proportion held in bonds. In addition a programme to improve the hedging of the fund against movements in fixed interest yields was implemented, further increasing security of benefits for with profits policyholders.

#### *Setting of surrender values*

The normal regular reviews of market value reduction (MVR) factors were carried out and changes to these factors were made as appropriate in accordance with the PPFM. Reviews of the surrender bases for conventional with profits contracts were also carried out.

#### *Management of the estate*

The methods of monitoring and managing the estate were further developed and clarified during 2009.

#### *Changes to PPFM*

No changes to the Principles have been made since the PPFM was first published on 30 April 2004.

Updated versions of the PPFM were published on 31 December 2009. All changes to the PPFM were approved by 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 clarify that payouts may be targeted above 100% asset share in order to distribute the estate over the lifetime of the qualifying with profits policies

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

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 distributing the estate.

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 again monitored closely in response to the continuing difficult investment conditions in the first half of the year.

No changes were made to the principles governing the way in which the estate is distributed to holders of qualifying with profits policies over the period that those policies remain in force, although, as stated earlier, the practices have been updated to clarify that payouts may be targeted above asset share.

##### *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.

The bonus rates declared differed between product types and classes. The bonus report made specific reference to compliance with the scheme of transfer.

Actuarial reports on reviews of, or proposed changes to, surrender and transfer 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 that the target ranges had been complied with during 2009.

## 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 the holders of with profits and deposit administration policies in the Scottish Life Closed 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 Scottish Life Closed Fund.

I have based these opinions on the information and explanations provided to me by the directors and management of Royal London and on my own knowledge and investigations. 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 Royal London Long Term Fund excluding the Scottish Life Closed Fund and the PLAL With-Profits Sub-fund and in respect of the PLAL With-Profits Sub-fund.

S Wilson BSc FIA  
With Profits Actuary  
1 June 2010