# Annual report and accounts 2000
## A year of transformation

Royal London

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References to 'Royal London Group', 'Royal London' or 'the Group' refer to The Royal London Mutual Insurance Society Limited and its subsidiaries.

References to 'Royal London Mutual' or 'the Society' refer to The Royal London Mutual Insurance Society Limited only.

References to 'Royal London policyholders' or 'Royal London policies' do not incorporate policyholders or policies previously within the funds of the United Assurance Group.

# **Profile** of Royal London

The year 2000 has been one of transformation as Royal London has set about diversifying income and reducing costs in order to deliver a better return to members.

In April 2000 United Assurance Group plc was acquired. The acquisition doubled Royal London's customer base and funds under management.

The acquisition of Scottish Life was announced in October 2000 subject to the approval of Scottish Life's members, the Court and regulators. Scottish Life will bring experience and expertise in the IFA market to the Group.

The Royal London Group provides life assurance, pensions, savings and investment plans, general insurance and fund management

At the end of 2000, Royal London had funds under management of £17.5bn

The Group employs over 4,500 people across the UK

Royal London has a direct sales force of 1,000 consultants operating from 40 offices across the UK

Royal London Mutual has no shareholders, and members are therefore the sole beneficiaries of the profits made by the Group

# **Chairman's** statement

## Transforming Royal London

I am delighted to report on a year in which our aim to become a significant long term force in the UK life, pensions and savings markets took shape. The acquisition of United Assurance Group (UAG) is now complete and the proposed purchase of Scottish Life has been announced and is on track. Together, these two transactions will provide the platform for the transformation of the enlarged Royal London Group.

The starting point for this transformation was a review of the Group's strategy which the Board undertook towards the end of 1999. We identified Royal London's key strengths – a strong financial position, investment returns which regularly exceeded those of its peer group, excellent product performance and a long tradition of providing advice to customers in their homes.

Our analysis also highlighted matters which needed to be addressed – a strong asset management capability which was under-utilised, a cost base which was too high relative to the level of sales, and an over-reliance on the direct sales force as the only method of distribution. The Board's conclusion was that without action Royal London's financial strength would be placed under strain.

The acquisitions address different strategic objectives. UAG's acquisition by Royal London strengthens our position in the core home service market and has increased our customer base considerably to over four million customers. In addition, substantial economies of scale resulting in reduced operating costs enable Royal London to deliver additional benefits to members.

The planned acquisition of Scottish Life will grow and diversify income. Scottish Life sells its products exclusively through Independent Financial Advisers (IFA), a sales channel now accounting for 57% of the life insurance market. It is anticipated that the transaction will be completed in the summer of 2001 and provide the Royal London Group with a strong position in the IFA market and expertise in pension products for which Scottish Life is well regarded.

The Board was able to approve bonuses for Royal London with profit policyholders for 2000 which improve returns. This was a direct consequence of our combination with UAG and is described in more detail in the Group Finance Director's review.

**Mutuality**

Royal London remains committed to its mutual status. The changes made this year reinforce our ability to deliver to current and future members the good returns which are the key objective for the business.

Royal London Mutual is accountable to its members. In December the Board proposed changes to the Articles of Association to an Extraordinary General Meeting of the Society. These were aimed at making the Board more

**Hubert Reid, Chairman**
In my first full year as Chairman, I am delighted that we have been able to make such progress towards delivering additional value for members.

accountable to members, principally by introducing proxy voting so that members could vote on resolutions relating to the Society's business without having to attend meetings in person, which for the vast majority is impossible.

The proposed new Articles were not approved at the meeting, which was most disappointing. We remain determined to modernise the Articles to a form which more closely reflects best practice in corporate governance and after a consultation process we will table further proposals in due course.

**The Board and management**

In April 2000 Barry Skipper retired from the Board. He had been a non-executive director since October 1995 and we thank him for his valuable contribution throughout that time.

Following the completion of the acquisition of UAG, we invited Andrew Longhurst and Alan Frost to join the Board as Deputy Chairman and Deputy Chief Executive respectively. They have added to our breadth of experience and provide useful insights and views.

Alan has tendered his resignation from the Board with effect from 31 March 2001 and we thank him for his support during the integration of UAG and Royal London.

Christopher Phillips, Chief Executive of Royal London Asset Management, has been invited to join the Board from 1 April 2001 and we look forward to welcoming him.

Our sincere thanks are due to Mike Yardley and his team for their management of the business during what has been a stretching year. It has been a remarkable achievement to deliver the changes that have taken place within the Group in such a short timescale.

**The future**

The year 2000 has been significant in the transformation of Royal London. There is still much more to be done, not least to ensure that the benefits from integrating UAG into Royal London continue to be delivered and that the acquisition of Scottish Life is brought to a successful conclusion.

Royal London has experienced a dramatic metamorphosis over the last year and is now well placed to achieve its goals. During this period we have continued to focus on our prime objectives of delivering good advice, high service standards and excellent returns to our policyholders. I look forward to reporting on our future progress.

**Hubert Reid, Chairman**

# **Group Chief Executive's** review

## After such a momentous year, this is a good opportunity to reflect on Royal London's progress

**Mike Yardley, Group Chief Executive**
We are transforming the Royal London Group so that we can continue to deliver value for members.

The key task for the business this year has been to realise Royal London's strategic ambitions. The acquisition of UAG presented Royal London with a tremendous opportunity to review its structure and operations, with the aim of improving the returns for policyholders. The Scottish Life acquisition will bring an important new dimension to Royal London's business. Alongside this we have been working towards the development of new channels of distribution and strengthening the asset management business.

**Transforming Royal London – the UAG acquisition**
When we announced the acquisition of UAG in February we were greatly helped by the stock market conditions at that time. New technology and "e" stocks were in favour and the prices of old economy stocks were depressed. This enabled Royal London to achieve the acquisition at a good price for policyholders. The Group Finance Director's review, later in this report, covers this in some detail.

Immediately following the completion of the transaction we embarked on the process of integrating the two businesses. The priorities were to:
- achieve cost savings from eliminating duplication across the Group
- identify and implement improvements to business processes
- bring together the sales forces into a single team, operating entirely under the Royal London brand from 1 January 2001
- maintain existing business alongside the integration programme.

**Operating structure**
Analysis of duplication across the Group focused on the two Head Office locations in Colchester, Essex and Wilmslow, Cheshire. In order to achieve the most efficient service it was decided to develop Wilmslow as the single operational centre for the Group, with central processing functions based there, including IT and Customer Services. When the integration process is complete around 1,100 employees will be based in Wilmslow.

Colchester will remain as the Head Office for the Group, with a focus on the strategic development and leadership of the Group as well as being the base for other functions such as Sales Management.

From 1 January 2001 the sales forces of the two companies have been combined into a single team operating under the Royal London name. The sales force of 1,000 financial consultants now operates from 40 Area Sales Offices, with 18 smaller satellite offices.

The former UAG office in Wilmslow, Cheshire is now the operational centre for the Royal London Group.

The use of palm-top devices is helping to improve the service and reduce the costs of door-to-door collections.

The product range has been reviewed and updated during the year and product literature has been rewritten and redesigned to make it easier for customers to understand.

The collection of premiums has been separated from the sales role as this provides a more cost-effective route to managing collections. The Group now has approximately 1,200 customer service representatives, collecting over £200m a year from around 1.2 million households. A key objective for 2001 will be to improve the efficiency of the collections process, for example through offering the facility for customers to pay by direct debit.

**Products**

The product range has also been reviewed during 2000. Royal London has stopped selling industrial branch policies, which are paid in cash with the premiums collected in person. With a steadily decreasing number of customers taking these policies they no longer provide value for money for many customers. All endowment products have been withdrawn from the product range, and replaced by other savings products which give customers greater flexibility.

For example, the new Unitised With Profits Savings Plan can accept increases and decreases in payment to accomodate fluctuating earnings patterns. At the same time the product retains the "smoothed" investment profile of a with profit product. A new personal pension was made available ahead of the launch of stakeholder pensions which meets the criteria for charges on stakeholders. An individual stakeholder product is being developed that will be ready for the launch of stakeholder pensions in April.

**Scottish Life**

The proposed acquisition of Scottish Life was announced in October 2000. For Royal London the attraction was in Scottish Life's track record in the IFA market. Scottish Life has a good reputation among IFAs, particularly for pensions products and for its effective use of technology. As part of the Royal London Group, Scottish Life will be well placed to develop its business further.

For Royal London policyholders, this represents an effective way to improve returns on capital. For Scottish Life, it will give access to the additional capital which was needed if it was to compete effectively. Royal London's financial strength makes it the ideal partner for Scottish Life.

As a mutual, Scottish Life must seek approval from its members before it can proceed, and then the transfer of business to Royal London will need further Court and regulatory approvals. The process to achieve these is under way and at present it is expected that Scottish Life will become part of the Royal London Group in the summer of 2001.

**Brian Duffin, Group Chief Executive, Scottish Life and Mike Yardley**
The proposed acquisition of Scottish Life will be good for both companies. Royal London gains a business firmly established in the IFA market. Scottish Life gets the backing of Royal London's financial strength.

The two management teams are already working closely to identify and plan the delivery of the benefits which will arise from Scottish Life joining the Group.

### Business performance

One of the key objectives of the year was the need to manage "business as usual" as well as the integration programme.

New business for the Group, including UAG since acquisition, was £103.4m in annual premium equivalent (APE) terms (APE is calculated as the annualised value of new regular premium contracts plus 10% of the value of new single premium contracts). This figure includes £21.2m relating to the pooled pension funds and £22.1m from the Royal London Growth and Income Trust, both of these being initiatives launched during 2000. The APE from UAG since acquisition was £18.3m. Excluding these factors, new business for Royal London was £41.8m, compared with £31.0m in 1999.

Despite the fall in equity markets, Royal London Mutual was able to declare increased bonus rates on its with profit policies for 2000. This increase reflects the value of benefits expected to arise from the integration of UAG and includes an additional bonus of £118m. The additional bonus is a reflection of the Board's determination to ensure that members reap the benefits of the acquisition.

It is recognised that the continuous improvement of customer service is key to the ongoing success of the Group. At present the required levels of service are not being achieved and we will be focusing close attention on customer service during 2001 in order to raise standards.

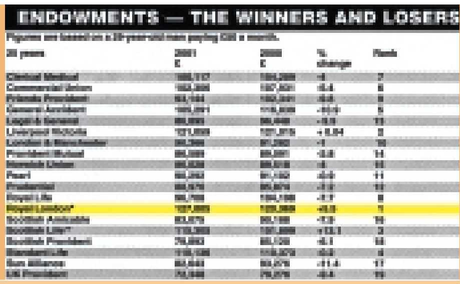
### New channels

For many years now Royal London has relied on the direct sales force as the sole method of reaching customers. As has been explained, Scottish Life will give us access to a new market through IFAs. In addition this year, plans have been developed for the use of call centres and new technology to target new customers but more importantly service existing customers in a more efficient and modern way. It will be down to the preference of individual customers as to how they want to do business with Royal London.

These plans are being taken forward by Chris Ide who joined us in October 2000 as Chief Executive, New Markets, having previously been Chief Executive, Europe for Swiss Life.

### Royal London Asset Management (RLAM)

RLAM manages the life funds of the companies in the Royal London Group and the Group's pension funds as well as managing external funds.



ENDOWMENTS — THE WINNERS AND LOSERS

The increases in bonus rates for 2000 will help maintain Royal London's track record of excellent with profit performance.

Past performance is not necessarily a guide to future performance. The value of investments can go down as well as up.

(Image source: *Daily Mail,* 28 February 2001)

Royal London's call centre will provide an alternative way for customers to buy Royal London's products.

External clients provide an important source of income for the Group and there is considerable potential to develop this activity. One of the further benefits of the acquisitions is the increase in funds under management which they will deliver. The UAG acquisition increased the Group's funds under management from £8.8bn to £17.5bn; following the Scottish Life acquisition the figure will rise to in excess of £27bn. This increase will help RLAM compete for external mandates.

During 2000 we appointed Christopher Phillips as Chief Executive of RLAM. Christopher joined from Deutsche Asset Management where he was Director of Strategy. His role is to take RLAM forward and develop its external business, while delivering the excellent investment performance which has been a hallmark of Royal London in recent years.

During the year RLAM gained six new pension fund clients and was appointed as a UK equity specialist by a fund of funds manager. Building on its strong performance record, RLAM is greatly expanding its sales and marketing efforts. The team is being increased and the marketing budget is being expanded to improve brand awareness in the institutional market place.

**Regulatory and compliance issues**

In last year's Annual Report we described the steps we were taking to improve standards of compliance across the Royal London Group, particularly following a period when we suspended sales so that all the sales force could be retrained.

I am pleased to say that the training programme and the new measures we put in place showed good results during the year. The new sales process was refined further as we combined the Group's sales operations. It ensures that financial consultants identify all of the customers' financial needs and give appropriate advice. The advice and sale is subject to review by sales management and by a central monitoring unit.

When we acquired UAG we were aware that it faced possible disciplinary action from the PIA following a monitoring visit in 1998. A review of business had already been set up and a provision had been made for the likely cost of compensation to those customers affected. These costs were provided for by UAG and will be met from the free reserves within UAG's life funds. In January 2001 the PIA announced that United Friendly and Refuge would each be fined £350,000 owing to compliance failures. Across the Group we remain committed to ensuring that sales are appropriate and reviewing any past sales which require further examination.


RLAM continued to broaden its services during the year, including the launch of a number of pooled pension funds.

There have been new proposals on polarisation, which have been the subject of a recent consultation paper by the FSA. The prime concern must be to ensure that customers understand the advice they are being given and who their adviser represents.

**Community and charity involvement**

We continued Royal London's Helping Hand programme of charity and community involvement. We made a further contribution to the Essex Community Foundation which manages our programme of donations in and around Colchester, and also supported Christie's Hospital in Manchester. Our employees continued to raise funds for our national charity partner, the National Deaf Children's Society and at the end of the year we were close to achieving our fund-raising target of £25,000. Employees and pensioners participated in the matched donations programme, under which funds raised by individuals for their chosen charities are doubled.

**Employees**

A particularly troubling aspect of the year was the redundancies which followed on from the integration of UAG into Royal London. The analysis of cost savings arising from the integration led us to the conclusion that a number of redundancies were inevitable if we were to deliver benefits to policyholders. However, that did not make it any easier to make the decision, nor did it reduce the distress for those directly affected.

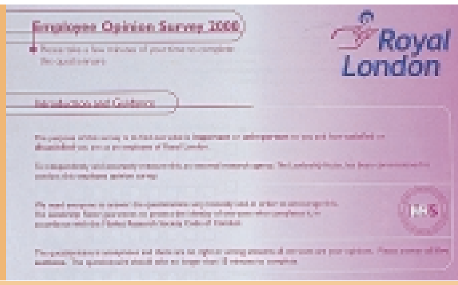
We endeavoured to give the greatest possible support to employees, particularly through the provision of extensive careers counselling and advice services.

Our employees contributed admirably throughout the year and I would like to take this opportunity to thank them all once again. It must have been particularly difficult for those who were facing redundancy, in many cases after long periods of service, but it is a credit to them that everyone has maintained high standards. Many of those leaving spoke of their commitment to Royal London and to its policyholders as the reason they continued to work so hard. I am confident that in the years ahead we can maintain the high standards of Royal London for those employees, many of whom will retain their links with the Group as policyholders, pensioners and members.

**Our strategy**

After such a momentous year this is a good opportunity to reflect on Royal London's progress. Our statement of intent sets out our aim to be a premier provider of financial services embracing the full breadth of the market place. Achieving this aim has involved acquisitions to provide better value in our

Employees continued to raise funds in support of the Group's national charity partner, the National Deaf Children's Society.




A comprehensive survey of employee opinion was undertaken in December, with a commitment to take appropriate action based on the results, to improve employee satisfaction.

products and to diversify our distribution so that customers can choose how to transact business with us. But there is still much more to do.

Operating profitably in the financial services market place has become more and more challenging. Consumers' expectations have increased, margins are declining, regulation has driven up costs and competition has intensified. Against such a background we must ensure that we seize the opportunities provided by an increasingly affluent public with a keener interest in financial management.

Once the acquisition of Scottish Life has completed, there will be three business units within the Royal London Group – our retail business, Scottish Life and Royal London Asset Management. The Group's key objective is to deliver value to current and future members and it is essential that each business unit makes a contribution.

Our retail business will be developed by adding new channels of distribution to work alongside the direct sales force. There will be a greater focus on targeting those segments of the customer base where there is an opportunity to build a long term business relationship. Alongside this there will need to be a concerted programme of improvements in customer service.

Scottish Life, distributing through IFAs, will need to ensure that the benefits of the Royal London acquisition are communicated effectively. The skills in product design and technology which Scottish Life already has will need to be developed, so that it can broaden its product offering to IFAs.

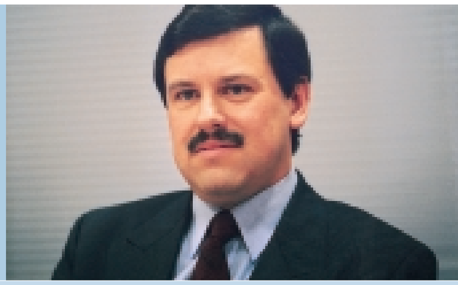
Royal London Asset Management has the opportunity to leverage business growth off its increase in funds under management supported by its good investment performance track record.

While the Group has three main business areas, there will be close co-operation in areas where there are benefits in sharing skills, such as product design. Collectively the business units will ensure that the value of Royal London for its members is enhanced.

I believe in creating and delivering tremendous value for our members, in uncompromising performance and in forward thinking applied to the provision of financial needs in life. By applying these beliefs we will have an exciting future as a successful business, a strong mutual and a significant participant in the financial services arena.

**Mike Yardley, Group Chief Executive**

# **Group Finance Director's** review



**Stephen Shone, Group Finance Director**
The Group's performance in 2000 has shown progress towards achievement of our financial objectives.

**Financial highlights**

- £396m total surplus distributed to Royal London policyholders compared with £253m in 1999
- £17.5bn funds under management
- Expenses planned to be reduced to less than 1% of funds under management during 2001
- Significant value generated for Royal London policyholders as a result of the UAG acquisition
- £984m pro forma gross premium income following the acquisition of UAG

Royal London has always prided itself on the strength of its financial resources and on its leading position in relation to payouts on maturing policies. These attributes, which support our objective to maximise the long term returns to our members, are only maintained through effective financial management of the business operations and through sound management of the Group's investments. I am pleased to note that the Group's performance in 2000 has shown progress towards achievement of our financial objectives.

**Bonus declaration**

Although investment markets performed poorly during the year the Group is benefitting from the cost savings from the acquisition of UAG. The Board therefore decided that it is appropriate to anticipate a portion of future savings in operating costs and to declare a one-off additional bonus allocation on most Royal London with profit policies. This special bonus represents a guaranteed amount to be added to all maturity and death claims, the total cost of which is £118m. The total surplus distributed to Royal London policyholders is £396m, which compares with £253m for 1999. The table below shows how the surplus has been distributed.

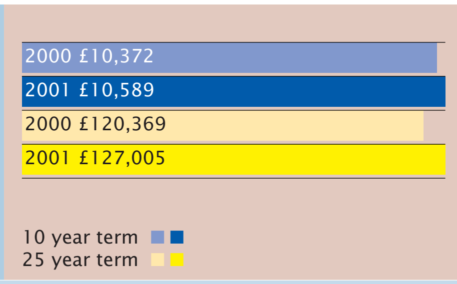
| | 2000 £m | 1999 £m |
|---|---|---|
| Regular bonuses added to policies | 132 | 109 |
| Additional bonus allocation to policies | 118 | – |
| Final bonuses paid in year | 146 | 144 |
| Total surplus distributed | 396 | 253 |

The savings have also been taken into account in setting bonus rates for claims in 2001. It is expected that final bonus payments to policyholders during the year will be approximately £174m compared with £146m in 2000.

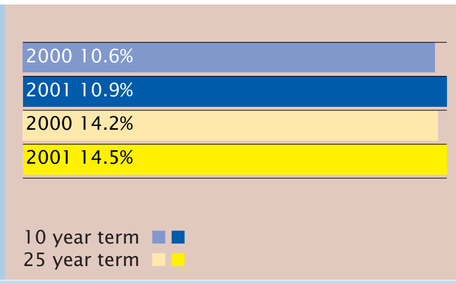
The effect of the declaration is to increase payouts on all Royal London's ordinary branch life contracts. Royal London is proud of its consistently strong record of market-leading payouts on maturing policies and this maintains that record. Details of the bonus declaration for 2000 for Royal London and other companies in the Group are set out on pages 43 and 44.

There has been recent comment about the operation of with profit policies, particularly reflecting concern that insufficient information is made available as to the methods of declaring bonuses. Royal London believes that by smoothing out the returns earned on investments, with profit offers an attractive option for people who do not want the risk of a fuller exposure to equity markets. The principles underlying Royal London's bonus policy are as follows.

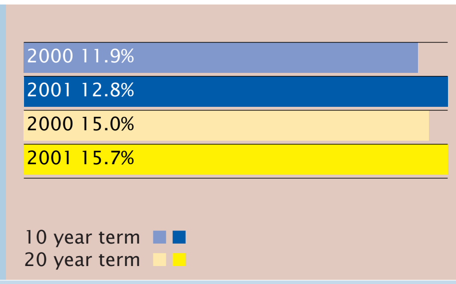
Royal London aims to maintain a free asset ratio (the ratio of a smoothed market value of assets to the value of liabilities) within a target range which




**Endowment returns at maturity**
The increased bonus rates announced for 2000 lead to increased payouts at maturity. The chart shows the payments for policies of 10 and 25 year terms maturing on 1 January in the year shown (based on a male with profit endowment policyholder aged 29 at inception and paying £50 per month).




**Endowment yields at maturity**
Yields at maturity on Royal London's OB with profit policies have increased at 10, 15, 20 and 25 year terms.




**Pension policy yields at vesting**
The annual gross rates of return on pension contributions have increased. The chart shows yields for policies of 10 and 20 year terms vesting at age 65 on 1 January in the year shown (based on a payment of £200 per month).

Past performance is not necessarily a guide to future performance. The value of investments can go down as well as up.

keeps the business solvent and provides sufficient capital to allow business growth. The free asset ratio helps determine the level of funds available for distribution to policyholders. Smoothing of asset values is usually carried out with reference to the average value of equity and property markets over the previous two years, adjusting for movements which may be attributable to underlying interest rates. In more volatile situations the approach may be modified. This limits the extent of fluctuations in the level of funds available for distribution.

The surplus is normally distributed as bonuses to policyholders broadly in proportion to their asset shares. Asset shares are estimates of the value of individual policies, taking account of investment returns, expenses incurred and the cost of life cover, and are smoothed by averaging over three calendar years.

Regular bonus additions, which cannot usually be taken away, are declared annually in line with trends in the expected future return on longer dated fixed interest securities. Such returns have fallen in recent years, consistent with long term expectations of low rates of inflation. Consequently, there will be a need to reduce regular bonus rates in future years.

As well as the regular bonus additions, a final bonus is added to each policy when a claim payment is made. Future levels of final bonus depend on the outcome of future economic and other events and are therefore subject to variation without notice.

**Acquisition of UAG**
The acquisition of UAG was completed in April 2000 at a cost of £1,557m. This was a very significant investment by Royal London, and without doubt the most significant transaction entered into by the company since its formation. It has more than doubled the size of the Group and at the same time has allowed the generation of economies of scale.

The value of assets acquired, including the present value of future surpluses on the UAG in-force policies and the tax benefits achieved from the transfer, on 1 January 2001, of the UAG businesses to Royal London, exceed the value of the consideration paid by £54m. We see this as real value acquired by Royal London, particularly given that the rationalisation of the two sales forces has been completed, with the combined sales force going forward expected to cost no more than Royal London's sales force prior to the acquisition.

Immediately following the acquisition, we set about planning the integration of the two businesses identifying total potential annualised savings of approximately £97m. The integration programme is now well into implementation phase and our latest forecasts and plans show potential savings of at least this level.

Of the total cost savings planned, approximately £51m represent savings to the cost of servicing existing policies. Using the same valuation methodology as is applied to the valuation of the present value of in-force business, we estimate the value of these servicing cost savings to be approximately £250m over a 10 year period.

In addition to the above, Royal London will benefit from enhanced revenues from the asset management and general insurance businesses acquired. The Board has estimated the value of this enhanced revenue to be in the region of £50m.

Clearly the acquisition of UAG is generating significant benefits for the policyholders of Royal London. These benefits, amounting in aggregate to approximately £350m, are all expressed in present value terms as they have different realisation timespans. We are confident that these benefits can be realised for our policyholders.

The businesses of each of the five insurance subsidiaries of UAG (Refuge Assurance, United Friendly Insurance, United Friendly Life Assurance, Canterbury Life and Refuge Investments), were transferred to Royal London, with Court approval, on 31 December 2000 in the case of general insurance and 1 January 2001 in the case of life, pensions and health insurance business.

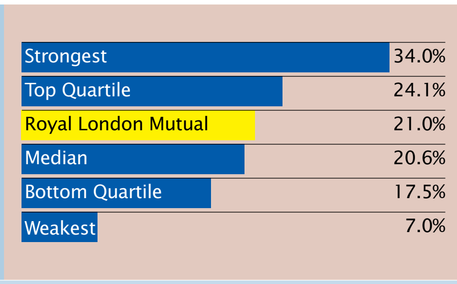
**Financial strength**

There is considerable interest at present in the financial strength of life assurance companies, and more particularly in their ability to meet their financial commitments in the future. Royal London continues to be one of the most financially secure companies in the industry.

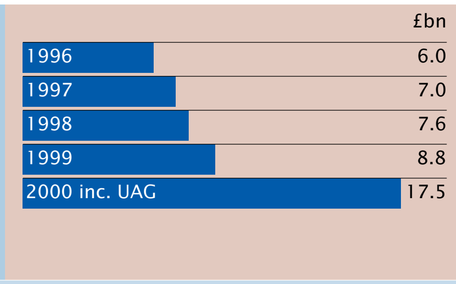
Standard and Poors, the independent rating agency, publish regular reviews of financial strength of life insurance companies. Their survey of 28 leading companies based on accounts published at the end of 1999 showed that with profit free asset ratios (defined as the excess of assets, after deducting the required minimum margin, over with profit liabilities plus the excess of assets) ranged from 7% to 34%. Taking into account the effect of the UAG acquisition and subsequent transfer of funds to Royal London as if they had taken place at the end of 1999, the corresponding ratio for Royal London Mutual was 21.0% at the end of 1999, placing the company comfortably in the middle of the range.

**Funds under management**

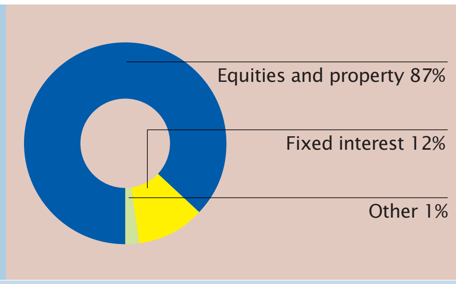
Royal London Asset Management (RLAM), a wholly owned subsidiary of the Group, is responsible for the management of all of the assets of the life funds




**Free asset ratio**
Royal London Mutual's pro forma free asset ratio for 1999, at 21.0%, was slightly above the current median for life insurers. (Comparative figures for 2000 are not yet available)




**Funds under management**
The total assets managed by RLAM have grown from £6.0bn in 1996 to £17.5bn at the end of 2000.




**Asset distribution 2000**
Royal London's asset distribution at end 2000 shows 87% invested in equities and property.

and the company's unit trusts. RLAM also manages funds on behalf of external pension fund clients totalling in excess of £1bn.

The total assets managed by RLAM have grown consistently over the past five years from £6.0bn in 1996 to £8.8bn in 1999 and, following the acquisition of UAG, to £17.5bn at the end of 2000.

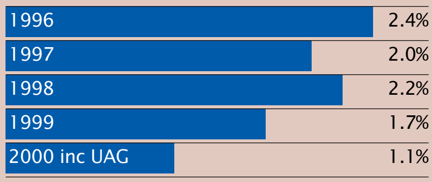
The financial strength of Royal London gives it the flexibility needed to be able to invest a larger proportion of its assets in equities and properties. These types of assets have the most potential to achieve capital growth over the long term, but may suffer a sharp decline in market value as was the experience in 2000. Without a large free asset ratio we would be forced to invest more cautiously, matching liabilities with suitably dated fixed interest securities and cash deposits, whose capital values are more stable but which tend to yield lower returns over the long term. Royal London's asset distribution within its with profit funds at end 2000 shows 87% invested in equities and property.

The year 2000 was characterised by highly volatile equity markets. The end result was that global equity markets provided a negative return to a sterling-based investor of 4.2%. The UK stockmarket fell by nearly 6%, and the lowest returns were from Japanese equities, which plunged by 28%, while European equity markets managed a small gain. Bond markets performed well, with UK government securities giving a positive return of 9%, while the best-performing asset category was direct property, which provided a return of nearly 12%.

In terms of relative investment performance, RLAM had a mixed year. UK equities performed broadly in line with their benchmark, while bonds performed well and overseas equities had a disappointing year. RLAM gained responsibility for the management of the United Assurance life funds during the course of the year, and the combined Royal London and United Assurance funds produced a negative total return of 2.2%. This result was largely due to the high weighting of equities in the funds, a policy that restricted performance in 2000, but has generated substantial gains for policyholders over the longer term.

## Expenses
The year 2000 was a very successful year for Royal London in terms of the effective management of our cost base. Total operational expenses in 2000 were £199m (excluding exceptional costs and deferred acquisition costs movement). Adjusted to include the pre-acquisition costs of UAG, the total expenses would be £228m compared with an equivalent total for 1999 (also restated to include UAG) of £248m, a reduction of 8%. The cost savings previously mentioned, which will be generated from the scale economies of integrating Royal London and UAG, should lead to a further significant reduction in the Group's cost base in 2001.

# **Group Finance Director's** review (continued)




**Expenses as % of funds under management**
Expenses as a percentage of funds under management continued their downward trend and are set to fall further in 2001.

Exceptional costs were incurred in 2000 in respect of the UAG acquisition, the subsequent fund rationalisation and also in respect of the integration of the two companies. These costs amounted to £42m of which £24m was in respect of redundancy.

The company's trend in expenses as a percentage of total funds over the past five years shows the positive approach of the company to cost management. It is anticipated that expenses as a percentage of funds under management will be less than 1% in 2001.

## Premiums and claims

Gross premiums written during the year include a significant single premium investment in the Group's new pooled pension product by the company's staff pension scheme. If this is excluded, total premiums written by Royal London are marginally down on the 1999 level, reflecting the fact that much of the new business of the Group is written through off balance sheet unit trusts. With the inclusion of UAG premiums since the date of acquisition the total premiums recognised by the Group were £884m.

Claims paid to policyholders amounted to £575m, before taking account of UAG, or £978m with UAG claims recognised since the date of acquisition.

## General insurance

The total annual general insurance commission received in 2000 was £10m. General insurance business in-force policies were all transferred to Royal London General with effect from 31 December 2000. The run-off of this business continues to progress, contributing an £8.8m profit during the year (1999 £8.5m).

## Pensions review and guaranteed annuity options

Progress of the pensions review is in line with the industry and PIA guidelines and on target to meet the deadline of June 2002.

Royal London cases are proceeding well, with 37% of priority two cases having been made offers at 31 December 2000, and a further 4.4% of cases found to involve no loss. Royal London has taken responsibility for the UAG pensions review. These cases are also on target, with 35% of priority two cases having been made offers at 31 December 2000, and a further 6% of cases found to involve no loss.

The outstanding provision in respect of both Royal London and UAG pensions review was £347m at 31 December 2000. Costs associated with the UAG review were taken into account before the acquisition by Royal London.

Our exposure to guaranteed annuity options is £27m, mainly related to the acquired businesses of UAG which had fully provided at the date of acquisition. The potential cost has been provided for on a very prudent basis. There is no impact on this year's bonus rates and nor is there expected to be any future impact.

**Exchangeable deferred shares**
Under the terms of the offer to acquire UAG, holders of convertible deferred shares (CDS) were offered exchangeable deferred shares (EDS) by RLM Finance as consideration for their holding.

Royal London has received an opinion letter from Bacon and Woodrow, a firm of consulting actuaries, stating that in their opinion, the Court approval of the AXA Scheme represents a clarification of, or change in, the industry practice regarding the potential attribution of the inherited estate of a proprietary life insurance company. Action is accordingly being taken to determine the amount of any value within the Refuge Assurance with profit sub-fund that may have become attributable to EDS holders. It is anticipated that resolution of this matter will take some time.

**Auditors**
We decided to appoint PricewaterhouseCoopers (PwC) as auditors to the enlarged Royal London Group following the acquisition of UAG. PwC were formerly auditors to UAG. I would like to take this opportunity to thank the audit team at KPMG for their support to Royal London in previous years.

**Summary**
The year 2000 has been a very successful year for Royal London. The company has increased its funds under management, reduced unit costs, increased new business and at the same time maintained a very strong position in the financial strength and maturity payout tables. 2001 will be a year of further development for the company as the benefits of the UAG acquisition will continue to emerge. It is also expected that the acquisition of Scottish Life will be completed.

We will continue to seek effective ways of putting the significant financial resources of the company to use for the benefit of our members. We recognise that the industry is changing and that we are operating in a more competitive and low margin environment. The steps we have taken in 2000 are significant, but we must continue to develop our business operations to ensure we maintain and build upon our position as a leading provider of financial services.

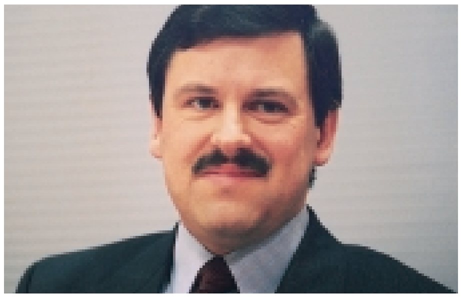
**Stephen Shone, Group Finance Director**











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# Board of directors

**1 Hubert Reid** [1, 2, 3, 4]
Chairman
Hubert Reid (60) was appointed to the Board as a non-executive director in April 1996 and became non-executive deputy chairman in January 1997 and chairman in July 1999. He is also chairman of Enterprise Inns plc, deputy chairman of Majedie Investments PLC and a non-executive director of the Taverners Trust PLC. He was previously managing director and then chairman of the Boddington Group plc, and chairman of Ibstock PLC and Bryant Group plc.

**2 Andrew Longhurst** BSc, FCIB, FBCS [1, 2, 3, 4]
Deputy Chairman
Andrew Longhurst (61) was appointed to the Board as a non-executive director and deputy chairman in April 2000 following the acquisition of the United Assurance Group plc. From 1967 to 1998 he was with Cheltenham & Gloucester Building Society (latterly plc) and was chief executive from 1982 and subsequently chairman. Between 1995 and 1998 he was a director of Lloyds Bank Plc, and then group director, customer finance of Lloyds TSB Group Plc. He joined the board of UAG in 1998 as a non-executive director and became chairman in November 1998. He is a non-executive director of Hermes Lens Asset Management Limited.

**3 Mike Yardley** FIA [2, 3]
Group Chief Executive
Mike Yardley (44) was appointed to the Board in November 1989. He joined Royal London in 1978 as a member of the investment team, was appointed investment manager in 1987, chief investment manager in 1993, investment and finance director in June 1996, deputy chief executive in January 1997 and chief executive with effect from April 1998.

**4 Alan Frost** BSc, FIA, FIMgt [2]
Deputy Chief Executive
Alan Frost (56) was appointed to the Board in April 2000. Following roles with London & Manchester Assurance and Sun Life Assurance Society, he joined Abbey Life Group plc in 1986 as investment director. After its merger with Lloyds Bank in 1988 he was appointed managing director of Abbey Life and a director of Lloyds Abbey Life plc. He joined the board of United Assurance Group in 1998 as group chief executive and was appointed a director and deputy chief executive of Royal London following the acquisition of UAG.

**5 Barry Fitzgerald** [2]
Sales Director
Barry Fitzgerald (56) was appointed to the Board in January 1997. He joined Royal London in 1972 and held various senior appointments in the sales force and at Colchester before being appointed general manager, sales and marketing in 1995, sales and marketing director in June 1996, and sales director in April 2000.

**6 Tim Melville-Ross** [1, 2, 3, 4]
Non-Executive Director
Tim Melville-Ross (56) was appointed to the Board in June 1999. He is chairman of Investors in People UK, DTZ Holdings plc, and Bank Insinger de Beaufort NV and a non-executive director of a number of other organisations including Bovis Homes Group plc and Manganese Bronze Holdings plc. He was director-general of the Institute of Directors from 1994 to 1999, and chief executive of Nationwide Building Society from 1985 to 1994.

**7 Tony Percival** FCA [1, 2, 3, 4]
Non-Executive Director
Tony Percival (61) was appointed to the Board in January 1999. He is a chartered accountant and he was a senior partner in London with Coopers & Lybrand until 1995. He has been an executive director of Kingfisher plc since 1995 and was group finance director until 1998. He is a non-executive director of British Standards Institution.

**8 Murray Ross** [2]
Legal Director and Secretary
Murray Ross (53) was appointed to the Board in January 1997. From 1972 to 1989 he was with 3M United Kingdom plc, latterly as head of legal and company secretary. He was a partner of Withers and then group legal advisor of Jupiter Tyndall Group plc before joining Royal London as solicitor in April 1994. He was appointed secretary in April 1996 and legal director and secretary in June 1996.

**9 Stephen Shone** BSc (Econ), FCA [2]
Group Finance Director
Stephen Shone (44) was appointed to the Board in January 1999 when he joined Royal London as group finance director. He trained as a chartered accountant with KPMG and on leaving in 1987 became finance director of Prolific Group. From 1990 to 1998 he was with Irish Life plc based in Dublin and St Albans, where he held a number of posts including group chief financial officer from 1996 to 1998.

Membership of Board Committees
1 Audit
2 Investment
3 Nomination
4 Remuneration