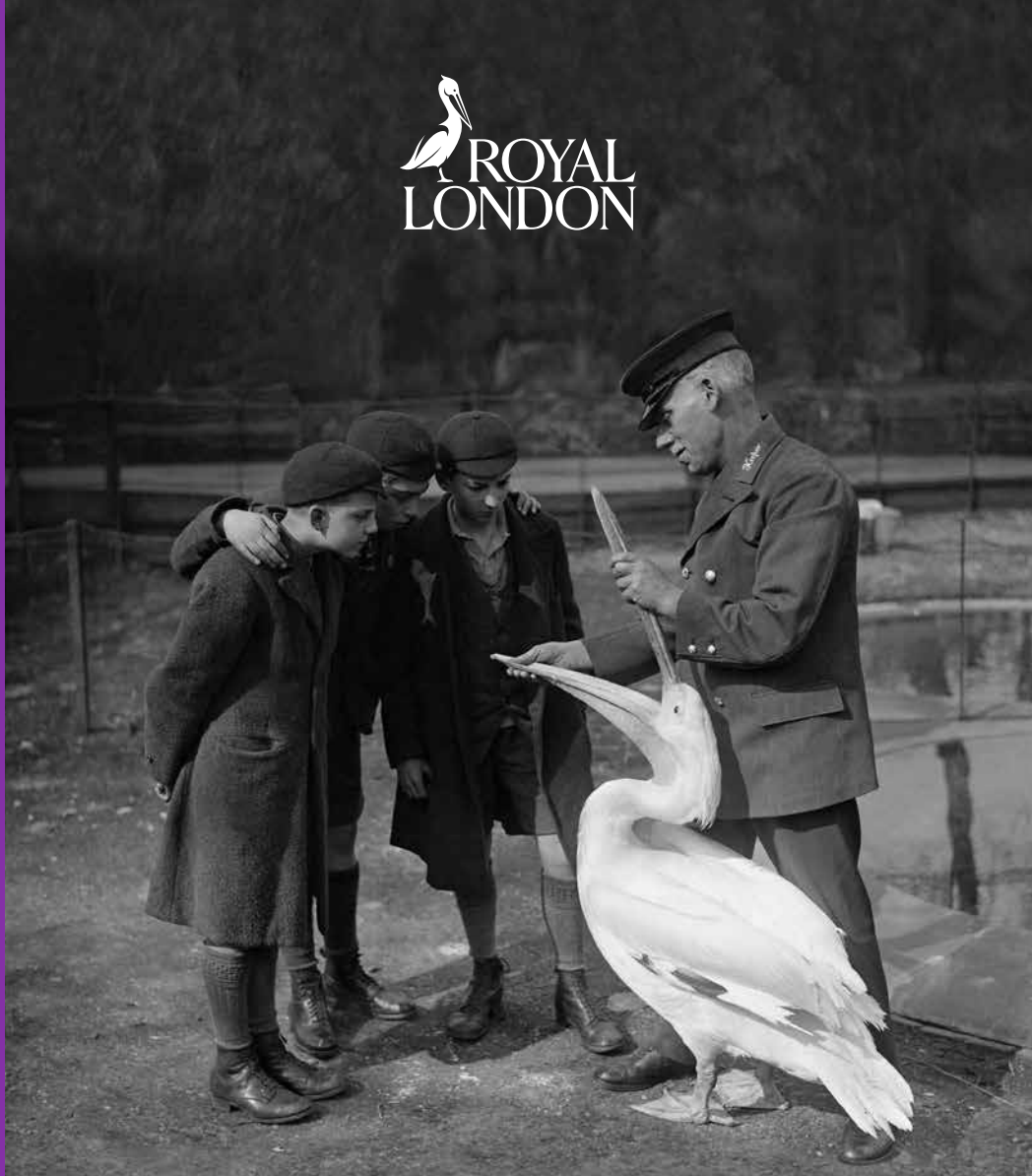
ROYAL LONDON



TAKE A CLOSER LOOK

A guide to the changes to the Principles and Practices of Financial Management (PPFM)

Investments

IF YOU WOULD LIKE A COPY OF THIS BOOKLET IN LARGE PRINT, PLEASE CALL US ON 0345 266 0799

CONTENTS

When we say 'we' in this booklet, we mean The Royal London Mutual Insurance Society Limited.

References in this booklet to life insurance business include pensions business.

Explanation of fonts

Although this document has been written in straightforward language it contains some technical language and terms. These have been included in the 'Useful terms' section and these defined terms can be identified by a **bold typeface**.

In section 2 'Summary of the changes to the **PPFM**' we use different fonts to describe the Principles and Practices, in the same way that we do in the **PPFM** itself.

The Principles are high level statements of the standards Royal London will follow in the management of the **fund**. The Principles are identified in the text by ***this typeface***, e.g.

> ***For* unit-linked with profits *business* Royal London *aims to ensure that claim values reflect the number and value of units held in each policy. The number of units will include those bonus units added to provide a share of the profits earned in the Royal London Main Fund.***

The Practices describe how **Royal London** intends to follow the Principles in the day-to-day management of the **fund**. The Practices are identified in the text by *this typeface*.

1 INTRODUCTION

This booklet tells you about the changes we're making to the **Principles and Practices of Financial Management (PPFM)** as a result of widening the scope of our With Profits business to include more policy types. The **PPFM** describes how we manage **With Profits policies**.

We're also taking the opportunity to make some changes that are necessary to reflect the introduction of the new European-wide solvency rules referred to as Solvency II that come into effect on 1 January 2016, and some other minor changes, including some to reflect the move to a single **Royal London** brand.

In addition, we've added the following items to our website:

1. Your questions answered

The answers to a number of questions that you may have after reading this booklet.

2. The view of the With Profits Committee.

The **With Profits Committee** exists to consider the interests of all With Profits policyholders in the Royal London Group and exercise independent judgement in advising the Board on the achievement of fair treatment of those With Profits policyholders.

The view of the **With Profits Committee** is a summary of their view of our plans to widen the scope of our With Profits business to include more policy types.

3. The independent expert's report

Our **With Profits Committee** enlisted the help of an independent expert, who was approved by our regulators to review our proposals. This is a summary of the independent expert's report.

You can read, download and print these documents from the website **royallondon.com/profitsharewp**. Or if you prefer, you can ask us to send you copies.

From 1 January 2016 you can view and download a copy of the new **PPFM** from our website **royallondon.com/PPFM**, or you can ask us to send you a copy by calling us on **0345 266 0799**.

As the PPFM is a technical document we also have customer friendly guides to how we manage our funds in the same area of our website. The guides aren't changing as a result of us widening the scope of our With Profits business but you may find them helpful in answering any general questions you have on With Profits.

Here are our contact details.

Address

Royal London
Royal London House
Alderley Road
WILMSLOW
SK9 1PF

Phone

0345 266 0799
International +44 1625 416648

We're available 9am to 5pm Monday to Friday, unless it's a Bank Holiday in England.

Phil Loney
Group Chief Executive

The way we manage **existing With Profits policies** will not change.

Royal London is the UK's leading customer-owned insurance and investments provider. We've been around for 150 years and we plan to be around in 150 years' time, not by staying the same but by evolving to meet the changing needs of our customers. We aim to have the best products, service and investment outcomes in the market, and translate these into the best outcomes and experience for our customers.

For a number of years we've boosted the savings of existing With Profits customers, by sharing some of our profits with them. However, the number of existing With Profits customers is falling. So, we think that the best way to respond to this is by making sure that more of our customers can share in our success, without diluting what we share with existing With Profits customers.

To do this, we're expanding our profit sharing approach to offer a new form of With Profits to all new customers who purchase a **Royal London** workplace or individual pension from the start of 2016. We're then extending this new form of With Profits to the existing customers who've bought these types of products from **Royal London** since the middle of 2001. The policies that qualify for the new form of With Profits will receive a smaller benefit than existing **With Profits policies**. The way that we manage existing **With Profits policies** will not change.

This approach will significantly increase the number of **Royal London** customers who will see their savings benefit from sharing in our profits. We believe that this change will ensure **Royal London** remains a strong, independent, customer-owned organisation with our customers' interests at the heart of everything we do.

2 SUMMARY OF THE CHANGES TO **THE PPFM**

This section summarises the changes to the PPFM. Please read it carefully.

CHANGES TO THE PPFM

We need to make a number of changes to the **PPFM** document to allow for the new form of With Profits – which we refer to in the **PPFM** as **'unit-linked with profits'**. We are also taking the opportunity to make some changes that are necessary to reflect the introduction of the new European-wide solvency rules referred to as Solvency II that come into effect on 1st January 2016. We are also making some other minor changes including some to reflect the move to a single Royal London brand.

The changes have been set out below in order that you can understand the background to each change.

Changes to reflect the introduction of 'unit-linked with profits' policies

There is no change to the **Guiding Principles** that apply to all business.

There is no change to the Principles underlying our **Management of the Estate**, but there is a change to the Practices. We have set out how we expect the existing and new policyholders will receive distributions of profits from our activities when the Directors considered it appropriate.

In particular we have clarified that a single profit 'pot' will be distributed rather than separate 'pots' for each line of business. We have set out that we intend to have the rate of distribution to existing with profits policies at around 8 times the rate applied to the new **unit-linked with profits** policies. For example, if we added 0.2% to the new **unit-linked** policies then we would expect to increase the **asset shares** of existing with profits policies by 1.6%, or 8 times as much. Before the Directors could make a material change to this factor the Directors would need to take independent advice.

Text added:

A single pool of profits arising from **Royal London's** *activities is determined by the* **Directors** *as being available for distribution each year. The size of the pool is at the* **Directors'** *discretion and may be zero. This pool is distributed to different types of policy in different ways. For* **conventional** *and* **unitised** *with profits business distributions are normally applied as enhancements to* **asset shares** *as set out in section 2.7.2. For* **unit-linked with profits** *policies distributions are normally applied as a regular bonus of additional units as set out in section 2.7.5.*

The rate of enhancement for **conventional** *and* **unitised** *with profits business is*

expected to be around 8 times the rate applied to **unit-linked with profits** *policies. The* **Directors** *have discretion to vary this multiple to reflect circumstances at the time following* **Actuarial Advice**. *However, should the proposed multiple be lower than 6 or higher than 10, the* **Directors** *must obtain* **Independent Actuarial Advice** *that supports such a change. The* **Regulators** *would be informed in advance of any proposed change to the long term expected rate of 8 times.*

There is no change to the Principles underlying our **Investment Strategy**, but there are changes to the wording of the Practices to clarify the position for the new policies. There is no change to our Practice of managing the assets backing policies like yours.

Underlined text added:

The unit linked business (including **unit-linked with profits** *business) in this pool is backed by appropriate matching linked assets.*

…

Royal London *publishes the asset mix at 31 December each year in respect of* **conventional** *and* **unitised** *with profits business in each asset pool. Such information may be provided in the annual report and accounts or it may be published on the website. Such information is also provided to policyholders by other means, for example in literature accompanying annual statements or bonus notices. Information on the approximate asset mix is also normally available quarterly.*

Each **unit-linked** *fund has its own investment aim and benchmark.*

There is a change to the wording of the Principles underlying **Policy Benefits Payable** to clarify that payouts for the new policies are not based on **asset shares**. There is no change to the principle of setting payouts on policies like yours.

Text added:

> *For* **unit-linked with profits** *business claim values reflect the number and value of units held in each policy. The number of units will include those bonus units added to provide a share of the profits earned in the* **Royal London** *Main Fund.*

There are corresponding changes to the wording of the Practices underlying **Policy Benefits Payable** to clarify that payouts for the new policies are not based on **asset shares**. There is no change to the practices of setting payouts on policies like yours.

Underlined text added:

The benefits payable on **unit-linked with profits** *policies depend on the number and*

value of units held and the concept of **asset share** *does not apply. The maturity amounts payable under* **conventional** *and* **unitised** *with profits policies are currently determined by the use of* **asset shares** *as a guide to setting payout levels.*

The wording of the Practices underlying **Calculation of Asset Shares** has been changed to confirm that payouts for the new policies are not based on **asset shares**. There is no change to the practices of calculating **asset shares** on policies like yours.

Text added:

> ***Group G* Unit-linked with profits** *policies issued by* **RL** *after 30 June 2001)*
>
> **Asset shares** *do not apply to this business. Instead policy benefits are determined by the number and value of* **unit-linked** *units allocated to the policy. The number of units will include those bonus units added to provide a share of the profits earned in the Royal London Main Fund.*

There is a change to the wording of the Principles underlying Smoothing to clarify that payouts for the new policies are not smoothed. There is no change to the Principle underlying Smoothing on policies like yours.

Underlined text added:

> **PRINCIPLES - Smoothing**
>
> **RL** ***aims to smooth payouts of conventional and unitised with profits policies at maturity to limit the amount of change between payouts on similar policies of the same term from one period to another. The aim is to reduce the effect of volatility in the underlying assets but the amount of any smoothing may be varied to ensure that policyholders are treated fairly and to protect the remaining policyholders. A consistent approach will be applied between different classes and generations of policyholder.*** **RL** ***may vary its approach to smoothing upon receiving*** **Actuarial Advice.**
>
> ***Any adjustments for smoothing may be positive or negative and any amounts withheld or advanced as a consequence of smoothing will be calculated so that policyholders are treated fairly. There is no explicit maximum cost or excess from smoothing in the shorter term. Overall the effect of smoothing is intended to be neutral over the longer term after allowing for the effect of any enhancements.***
>
> **Unit-linked with profits** ***business does not have any smoothing applied.***

There are corresponding changes to the wording of the Practices underlying Smoothing to clarify that payouts for the new policies are not smoothed. There is no change to the Practices underlying Smoothing on policies like yours.

Underlined text added:

The amounts by which payouts on similar **conventional** *and* **unitised** *and with profits policies with a similar term to maturity vary from one year to the next are smoothed. Our approach to setting payouts on* **conventional** *and* **unitised** *with profits policies at maturity is to start by looking at both recent payout levels and* **asset shares**.

The wording of the Practices underlying **Final Bonus and MVR Scales** has been changed to indicate that we do not expect to add final bonus to the new policies. There is no change to the Practices underlying the calculation of Final Bonus and **MVR** Scales for policies like yours.

Text added:

Unit-linked with profits *policies in Groups G:*

Final bonuses are not currently applied to **unit-linked with profits** *policies.*

There is a change to the wording of the Principles underlying **Regular Bonus** to describe how this applies to the new policies. There is no change to the Principle underlying Regular Bonus for policies like yours.

Underlined text added:

In determining the bonus rates, the objective of the* Directors *is to meet the reasonable benefit expectations of policyholders, treating classes and generations of with profits policyholders fairly. The aim in setting regular bonus rates on* conventional *and* unitised *with profits policies is to increase guaranteed policy values over time at rates which it is expected can be maintained over the longer term, taking into account economic conditions and the economic outlook at the time.

Regular bonus rates on* unit-linked with profits *policies are set with the aim of distributing to them a fair proportion of the profits from* Royal London's *activities.

There are corresponding changes to the wording of the Practices underlying **Regular Bonus** to describe how this applies to the new policies. There is a change to the Practices underlying Regular Bonus for policies like yours. We have set out that Regular Bonus on policies like yours will be increased by the same rate we apply to the new policies.

Underlined text added:

The regular bonus rates are normally set and declared once a year. The aim of setting regular bonus rates for **conventional** and **unitised** with profits business is to build up the guaranteed bonus gradually over the term of a policy whilst permitting sufficient surplus to emerge at maturity to support a final bonus.

…

For **unit-linked with profits** policies the regular bonus is normally declared once a year and reflects a fair distribution to such policies of profits earned by **Royal London's** activities. Distributions of profits from **Royal London's** activities to **conventional** and **unitised** with profits policies are applied as enhancements to **asset share** and are primarily reflected through increased final bonus.

An **additional regular bonus** will be added to **conventional** and **unitised** with profits policies at the same rate as the regular bonus awarded to **unit-linked with profits** policies. This will be applied at the same time as the normal **regular bonus** for those policies.

…

The levels of normal regular bonus declared on **conventional** *and* **unitised** *with profits policies are currently determined by projecting* **asset shares** *as described in the section* ***"Policy Benefits Payable"*** *over the expected lifetime of the policies.*

Changes to reflect the introduction of Solvency II

The definition of the 'Estate' is being changed in the Practices underlying **Management of the Estate**.

Underlined text added, struck out text removed:

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~~ a multiple of the* **Regulatory Capital Resource Requirements** *taking into account the uses of the* **Estate** *and the* **Directors'** *attitude to the risk of failing to meet its* **Regulatory Capital Resource Requirements**.

…

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~~ a multiple*

of the **Regulatory Capital Resource Requirements** *for that sub-fund.*

…

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.*

In the Practices underlying **Business Activities**

Struck out text removed:

No business risk should arise from the issue of ~~Tier One or Tier Two~~ capital instruments by **Royal London** *or its subsidiaries which have the benefit of a subordinated guarantee.*

Changes to reflect the move to a single brand and other minor changes

There are a number of changes to the explanatory text that sits around the Principles and Practices themselves. These changes aim to put the changes to the formal items into proper context. The following changes are to the Practices.

In the Practices underlying **Business Activities** the following reflects a more recent example and removes business units that are being brought within the Royal London brand.

Underlined text added, struck out text removed:

Risk

Exposure to risks arising from the development of new business units such as **Bright Grey**~~*, and to risks from investments such as in house investment management companies or service companies or purchases of other businesses such as*~~ **Scottish Provident** *our 'Direct to Consumer' business.*

Mitigation

Detailed financial planning, budgeting and monitoring processes are maintained.

In the Practices underlying **Policy Benefits Payable** the following reflects the move of 'Scottish Life' to the Royal London brand.

Underlined text added, struck out text removed:

Target maturity payouts are 100% of **enhanced asset share** *for policies in the following Groups*

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

C (Royal London Funeral Investment Plan issued after 31 December 2014 and

with profits benefits of ~~**Scottish Life**~~ **Royal London Intermediary** *policies issued after 30 June 2001)*

*D (***conventional OB** *and* **IB** *policies issued by* **UF** *and* **conventional IB** *policies issued by* **RA***)*

*F (***conventional** *with profits policies issued by* **RA** *before 1 January 2001*

In the Practices underlying **Policy Benefits Payable** the following reflects recent moves to bring certain whole of life policies within the scope of target range investigations.

Underlined text added:

In particular the target ranges do not apply in the following circumstances:

- *Where the effect of policy guarantees leads to a higher figure;*
- *Some minor classes of business where* **asset shares** *are not calculated;*
- *Where the* **asset share** *does not represent a* **fair** *guide to the payout, for example altered (including paid-up) policies, certain* **conventional** *whole of life policies and policies with very small* **asset shares**

In the Practices underlying **Calculation of Asset Shares** the following reflects the move of 'Scottish Life' to the Royal London brand.

Underlined text added, struck out text removed:

Group C *(Royal London Funeral Investment Plan issued after 31 December 2014 and with profits benefits of* ~~**Scottish Life**~~ **Royal London Intermediary** *policies issued after 30 June 2001)*

3 USEFUL TERMS

'Actuarial Advice'
Advice provided by the Actuary responsible for advising the **Directors** on discretionary or technical aspects of the management of the with profits business. Under current regulatory rules this is the With Profits Actuary or the Head of Actuarial Function.

'Actuary'
Someone who assesses risks and costs, in particular those relating to life assurance and investment policies, using a combination of statistical and mathematical techniques.

'asset share(s)'
The share in the assets of a with profits fund that a with profits policy is deemed to have. The **asset share** is calculated by accumulating the premiums paid less all applicable expenses and charges with the investment return credited to with profits business over the lifetime of the policy. Where the general term **asset share** is used it means **bare asset share** or **enhanced asset share** according to the context.

'bare asset shares'
Asset shares with no enhancements.

'conventional'
Refers to a with profits policy that has a guaranteed amount of cash or pension to which bonuses are added.

'Directors'
The **Directors** of The Royal London Mutual Insurance Society Limited from time to time. For practical purposes the Directors may agree to delegate certain decisions to a sub-set of their number.

'enhanced asset shares'
Asset shares with either temporary or permanent enhancements.

'estate' or 'Estate'
General term used to describe the excess of the assets realistically required to meet the current expectations of policyholders and to settle other liabilities relating to each class of business to which it relates. The **RL Estate** may be used to provide support to sub funds where necessary and where allowable under the terms of relevant schemes of transfer. It is also used to fund new business.

'fair', 'fairly', 'fairness'
References to and use of the concept of fair, fairness or treating policyholders fairly in this document relates to the obligation created by Principle 6 of the **Regulator's** Principles for Businesses to, amongst other things, treat customers fairly.

'FCA'
Financial Conduct Authority.
An independent, non-governmental body that regulates the UK insurance industry in conjunction with the Prudential Regulation Authority (**PRA**).

'fund'
Refers to the **RL Main Fund**.

'IB'
Industrial Branch Business.
Policies which, when taken out, had a premium receipt book as well as a policy document. When the policies were taken out, premiums were payable either to a collector or by standing order to a branch office.

'Independent Actuarial Advice'
Actuarial Advice provided by an actuary independent from Royal London and approved by our Regulators.

'Mutual'
Company without shareholders, effectively owned by the With Profits policyholders, who are entitled to a share of any surplus funds at valuation. These 'surplus' distributions are termed bonuses.

'MVR'
A market value reduction which may be applied on claims under certain **unitised** policies in certain circumstances. An **MVR** reduces the value of guaranteed benefits plus final bonus (if applicable) and effectively acts like a negative final bonus. An **MVR** is only applied if the value of the investments underlying a policy has fallen sufficiently below the value of the guaranteed benefits plus final bonus (if applicable) cashed.
This ensures fairness between those policyholders who cash in benefits and those who remain. An **MVR** will not usually be applied on death or on certain pre-defined circumstances as laid out in the policy conditions.

'OB'
Ordinary Branch Business.
Ordinary Branch policies are:

- All pension policies, and
- Life policies, when taken out, had premiums payable in a lump sum, or every there, six or twelve months, or monthly from a bank or building society account.

'PLAL'
Phoenix Life Assurance Limited.

'PLAL With Profits Sub-fund'
The fund into which certain assets and liabilities of **PLAL** were transferred with effect from 29 December 2008, a separate closed sub-fund of the **RL LTF**.

'PPFM'
Principles and Practices of Financial Management. The Principles are high level statements of the standards that a life insurance company intends to follow over the longer term in the management of its With Profits fund. The Practices describe how the company intends to follow the Principles in the day to day management of the fund. The Practices also describe the approach to managing the fund over the shorter term and to responding to external changes that affect the fund. The Principles and Practices evolve as circumstances and the business environment change. We have separate ***PPFM***s for the *Royal London Main Fund*, the *PLAL With-Profits Sub-Fund*, the *Royal Liver Sub-Fund* and the *Scottish Life Closed Fund*.

'PRA'
Prudential Regulation Authority. An independent, non-governmental body that regulates the UK insurance industry in conjunction with the Financial Conduct Authority (**FCA**).

'RA'
Refuge Assurance plc.

'RA OB'
OB business originally issued by **RA**.

'RA OB Fund'
The **RA OB** with profit sub fund into which the **OB** with profit liabilities of **RA** were transferred with effect from 1 January 2001. The assets and liabilities of the fund were transferred into the **RL Main Fund** on 31 December 2006 whereupon the fund ceased to exist.

'Regulator'
The **FCA**, **PRA** or any other regulatory body as defined in accordance with the provisions of the UK Financial Services and Markets Act 2000 (or any such legislation that supersedes it).

'Regulatory Capital Resource Requirements'
The capital resources that **Royal London** must hold in accordance with regulatory requirements from time to time.

'RL'
The Royal London Mutual Insurance Society Limited.

'RL Main Fund'
Royal London main fund which includes **IB** and **OB** business originally issued by **RL**, **UF** and **RA**. The assets and liabilities of the **RA OB Fund** were transferred into this fund on 31 December 2006.

'Royal London'
We use the term **'Royal London'** in this document to refer to The Royal London Mutual Insurance Society Limited and (where the context so requires) its subsidiaries. **Royal London** is a brand name.

'Royal London Intermediary'
The business unit within **Royal London** that distributes policies through intermediaries. From 1 July 2001 to 23 November 2014 the brand name 'Scottish Life' was used. From 24 November 2014 this business was rebranded to use the main **Royal London** brand.

'Scottish Life'
A division of **Royal London** manufacturing and distributing products under the **Scottish Life** brand from 1 July 2001 to 23 November 2014.

'Scottish Life Closed Fund'
The separate closed sub-fund of the *Royal London Long Term Fund* that holds certain life insurance business of The Scottish Life Assurance Company.

'trustee'
Individual or corporate body who looks after the assets of a trust and manages the trust in accordance with terms and conditions agreed verbally or in writing.

'UF'
United Friendly Insurance plc.

'unitised'
Refers to a with profits policy where premiums have been used to purchase with profits units, rather than **unit-linked** units.

'unit-linked'
Refers to a policy whose value depends on the number and value of units held in one or more linked funds.

'unit-linked with profits'
Refers to a **unit-linked policy** which participates in the profits of RL through receiving bonuses from time to time.

'With Profits Committee'
The purpose of the Committee is to consider the interests of all With Profits policyholders in the Royal London Group and exercise independent judgement in advising the Board on the achievement of fair treatment of those With Profits policyholders.

Members of the Committee are appointed by the Board and consist of five members, three of which must be independent members. At least one of the independent members must be a Fellow of the Institute and Faculty of Actuaries. All members of the committee must have recent relevant experience in the conduct of With Profits business and the fair treatment of With Profits policyholders.

'With Profits Policy'
A type of policy that shares in certain of the profits made in either a With Profits fund or the wider company, depending on the terms of the relevant ***PPFM***.

Royal London
1 Thistle Street, Edinburgh EH2 1DG
royallondon.com

All literature about products that carry the Royal London brand is available in large print format on request to the Marketing Department at Royal London, 1 Thistle Street, Edinburgh EH2 1DG.
All of our printed products are produced on stock which is from FSC® certified forests.

September 2015 2TB1779