A guide to how we manage our with profits fund

Contents

About this guide

This guide tells you:

- how we manage our with profits fund
- how our with profits policies work, and
- what benefits policyholders can expect from them.

The guide sets out our current approach. We might change the approach from time to time to respond to changing circumstances.

We use certain terms in this guide that need a more detailed explanation than we can give in the text. We have highlighted these *like this* and included them in a summary of useful terms at the beginning.

Who should read this guide?

You should read this guide if you have a *unitised* with profits policy (including an Individual Savings Account (ISA) invested in with profits) that was taken out with *Royal London*, *Refuge Assurance* or *Police Mutual*. It explains how we currently manage the *Royal London with profits fund* and how this affects your policy.

On our website we refer to this guide as Guide 3.

We refer to the *'Royal London with profits fund'* as the 'fund' throughout the rest of this guide.

You should read this guide and keep it safe with your other policy documents, which you may find helpful to refer to as you go through it. The guide does not change the terms of your policy; it gives you further information to help you understand it better.

1 Useful terms

Asset share

The accumulation of premiums paid into a policy after taking off amounts to cover expenses, charges and tax (for life policies where applicable) and after crediting or debiting amounts to reflect the investment returns achieved by the fund. From time to time we may also make adjustments to allow for any increases (enhancements) or deductions to *asset share*. We also take off a *transfer to the estate* from the *asset shares* of policies taken out with *Refuge Assurance.*

Co-operative Insurance Society

Co-operative Insurance Society Limited.

Estate

The amount by which the investments of the fund are greater than the guaranteed benefits and bonuses already promised to policyholders.

Industrial Branch

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 to a collector.

Market value reduction

A reduction that we may apply to the value of a policy when part or all of it is being cashed in. We apply it to ensure that we treat everyone in the fund fairly, both those leaving it and those staying in it.

There are certain circumstances where we cannot apply a *market value reduction*, for example: at the pension date originally specified or on death.

We also cannot apply a *market value reduction* to with profits ISAs taken out before 6 April 2001.

Please refer to your policy document for the circumstances that apply for your policy.

Members

Members are policyholders who 'own' *Royal London*. They can attend the Annual General Meeting and vote. Some categories of with profits policyholder are not *members*, including policyholders whose policies were formerly with *Co-operative Insurance Society, Phoenix Life Assurance*, *Police Mutual, Refuge Assurance, Royal Liver, Scottish Life or United Friendly.*

Ordinary Branch

All pension policies; and life policies which, when taken out, had premiums payable in a lump sum, or every three, six or twelve months, or monthly from a bank account.

Phoenix Life Assurance

Phoenix Life Assurance Limited.

Police Mutual

Police Mutual Assurance Society Limited.

Quarterly pool

For the purposes of setting final bonuses and *market value reductions* units bought in a calendar quarter are usually pooled together. However we may decide to create other pools of units, for example following a very large market movement.

Refuge Assurance

Refuge Assurance Plc.

Regulators

The Financial Conduct Authority and the Prudential Regulation Authority.

RL open fund

Contains all the policies in the *Royal London with profits fund*.

Royal Liver

Royal Liver Assurance Limited.

Royal London

The Royal London Mutual Insurance Society Limited.

Royal London (CIS) Sub-Fund

The *sub-fund* into which *Co-operative Insurance Society* policies were ultimately transferred.

Royal London with profits fund

The fund that consists of the with profits and non profit policies of *Royal London* including all transferred policies from *Refuge Assurance, Scottish Life, United Friendly* and *Police Mutual* and non profit policies transferred from *Phoenix Life Assurance*. The with profits policies are held in the *RL open fund*.

The with profits policies transferred from *Phoenix Life Assurance* are in a separate *sub-fund*, the PLAL With-Profits *Sub-fund*. All the policies transferred from *Royal Liver* are in a separate *sub-fund*, the *Royal Liver Sub-Fund*. All the policies transferred from the *Co-operative Insurance society* are in a separate *sub-fund*, the *Royal London (CIS) Sub-Fund*.

Scottish Life

The Scottish Life Assurance Company.

Smoothing

The way in which we reduce the impact on policyholder payouts of the variation in the returns earned by the fund.

Sub-fund

A group of policies and their assets that are held separately to other groups of policies that we administer. Each *sub-fund* is managed separately from other *sub-funds*.

Transfer to the estate

We transfer a share of the profits made on certain policies to Royal London's estate. This is the same transfer that was previously made to shareholders of *United Assurance Group*. The right to this transfer was given to *Royal London* when it bought the shares of *United Assurance Group*.

United Assurance Group

Consisted of *Refuge Assurance*, *United Friendly* and other companies writing non profit business and/or other non life assurance business.

United Friendly

United Friendly Insurance Plc.

Unitised

A with profits policy such as yours where premiums are used to purchase units in a with profits fund.

With profits bond

A *unitised* with profits life policy where the premium is paid in a single lump sum.

2 Principles and Practices of Financial Management

We manage the fund by following our Principles and Practices of Financial Management (PPFM). You can read the current PPFM by visiting our website royallondon.com

The Principles are high level statements setting out how we intend to manage the fund over the long term. The Practices are more specific statements that describe how we intend to follow the Principles in managing the fund on a day-to-day basis.

The PPFM is a very detailed technical document so this guide sets out a summary of the key points in simpler terms. If there is any conflict between the simplified wording in this guide and that in the PPFM, we will apply the wording in the PPFM.

We may change the Principles and Practices from time to time to respond to changing circumstances. If we make any changes, we will publish them on our website royallondon.com. If the changes are significant, we'll send you an updated copy of this guide with your yearly statement.

Our Guiding Principles

We follow some overall Guiding Principles when managing the fund:

We will manage the fund in a sound and prudent manner and aim to:

- make sure that, at the appropriate time, we can pay all the amounts guaranteed to our policyholders
- uphold all policy terms and conditions
- satisfy our *regulators* that we are managing the fund in an appropriate way, and
- treat all our policyholders fairly.

We have established a With Profits Committee to provide independent advice on the way we manage the fund and to help us treat with profits policyholders fairly and monitor our compliance with the PPFM.

3 What is a with profits policy?

A with profits policy is a legal contract between you and us. The premiums that you pay us are used to buy units in the fund at the unit price applicable on the day you buy them. On *Police Mutual* policies with a guarantee, these units are known as Guaranteed units but will be referred to as "units" in this document. *Police Mutual* policies without a guarantee do not receive Guaranteed units but their premiums are still invested in the with-profit fund.

The fund invests in a wide range of investments and with profits policyholders share in the profits and losses made on these investments. Instead of receiving direct investment returns such as dividends or interest, with profits policyholders receive bonuses, which we add to their policies.

Royal London is a mutual company which means that we do not have any shareholders. All the profits and losses made by us remain in the business for the benefit of policyholders and *members* rather than a share of the profits being paid to shareholders.

If your policy is a *with profits* bond taken out with *Refuge Assurance*, a share of the profits was originally paid to the shareholders of *United Assurance Group*. As a result of the transfer of the policies to *Royal London* on 1 January 2001 these payments are now made to *Royal London's estate*. We call this the *transfer to the estate*.

Guaranteed amounts

With most policies, we guarantee to pay the face value of the units you hold in the fund at certain times in your policy. We may also add a final bonus at these times.

Examples of times we guarantee your benefits are:

- when you take your pension benefits at the pension date, or
- the date of death if you die before the end of the policy.

There may also be other times when we will guarantee to pay you at least the face value of the units. Your policy documents contain details of these times.

Bonuses

We aim to increase the value of your units throughout the term of your policy by declaring regular bonuses which increase the unit price. Some policies do not receive regular bonuses. The regular bonus rate may be zero. We recalculate the unit price daily, or weekly for *Police Mutual* policies.

We may also pay a final bonus when you cash in some or all of the units allocated to your policy. However, in some situations we could pay you less than the face value of the units allocated to your policy by applying a *market value reduction*.

There are more details on the bonuses we pay and the *market value reduction* under question 5.

4 How do you decide how much to pay me?

We base the amount we pay you on the face value of the units you hold in the fund at the date you decide to leave the fund. We may also pay you a final bonus on top of this or we may apply a *market value reduction* to reduce the amount we pay you in certain circumstances. See question 5 for more information on when we may apply a *market value reduction*.

For *Police Mutual* policies without Guaranteed units payouts are based solely on *asset shares*.

When determining how much we will pay you we aim to be fair to you and to the other policyholders remaining in the fund.

We use *asset shares* to help us decide how much to pay you at the set event or date in your policy schedule or on death.

This is how we calculate *asset shares*.

- We start with the premiums paid into the fund.
- Then we take off our expenses, tax (for life policies where applicable) and the cost of providing benefits and guarantees to the policies. For certain policies taken out before 1 January 2001, we also make a *transfer to the estate*.
- Then we allow for the investment returns earned by the investments backing the policy.

We also include any enhancements or deductions we have made.

For some policies we calculate sample *asset shares* based on a *quarterly pool* of units bought. We calculate sample *asset shares* so that we can keep track of the relationship between the amounts we pay you and the investments available in the RL *open fund*. This ensures that the bonuses we pay are fair across the whole range of with profits policies.

Asset shares are simply a measuring tool. We use *asset shares* or sample *asset shares* to set bonus rates and we use *asset shares* in total to assess the size of the *estate*. We do not quote *asset shares* on individual policies.

For all business not taken out with *Police Mutual*, we compare the sample *asset share* with the sample value of the units held in the fund for each *quarterly pool*.

If the sample *asset share* is higher than the sample value of the units held in the fund for each *quarterly pool*, we may pay a final bonus for this *quarterly pool*. However the amount of final bonus we pay also depends on the amount of *smoothing* that we apply at the time of payment.

If the sample *asset share* is lower than the sample value of the units held in the fund for each *quarterly pool*, we may apply a *market value reduction* to this *quarterly pool*.

For business taken out with *Police Mutual* the approach is similar but uses actual policies instead of samples and *final bonuses/market value reductions* are calculated for each policy instead of in *quarterly pools*. Where there are no Guaranteed units the payout will be based on the *asset share* after allowing for *smoothing*.

We apply *smoothing* to the amounts we pay to protect you from temporary ups and downs of the investments held by the fund. We explain *smoothing* under question 6.

The range in which we aim to target most maturity values as a percentage of *asset share* is 75% to 125%.

At any time we may change the way we determine how much each policy receives in the future but only if the change is fair.

5 How do you decide bonuses?

We usually announce the rate of regular bonus once a year. We may change the rate more often than once a year and we can change it at any time.

We regularly check the rates of final bonus and make a change when needed. This could happen when we need to reduce the amounts we pay to policyholders leaving the fund to protect the interests of remaining policyholders if, for example, investment conditions are bad. Alternatively we may need to increase the amounts we pay if, for example, investment conditions are exceptionally good.

Regular bonuses

We announce regular bonuses that increase the unit price used to calculate the value of your policy gradually over the policy's lifetime.
Once added, a regular bonus becomes part of the unit price and cannot be taken away. However in some circumstances we may not pay you the face value of the units.

We decide regular bonus rates by considering what we think the fund can afford to pay now and in the future. To do this we look at current investment conditions and the economic outlook for the future.

If we feel that announcing a regular bonus would harm the ability of the fund to pay the amounts promised to policyholders when they are due either now or in the future, we may decide not to announce a regular bonus.

Similarly we may reduce the regular bonus where continuing with the previous rate might lead to guarantees at a level that unduly restricts investment freedom.

We may announce different regular bonuses for different types of policy in order to treat each policy group within the fund as fairly as possible (for example life policies and pension policies).

We try to introduce changes to the amount of regular bonus we announce gradually over time.

Final bonuses

We may also announce final bonuses. We do this to increase what you get back from your policy if the regular bonuses we have added to your policy do not fairly reflect the *asset shares* that we have calculated for your particular type of policy.

For all business not taken out with *Police Mutual*, we compare the sample *asset share* with the sample value of the units held in the fund for each *quarterly pool*. For *Police Mutual* business the approach is similar but uses actual policies instead of samples and *final bonuses* are calculated for each policy instead of in *quarterly pools*. We determine a scale of final bonuses after we have applied the appropriate *smoothing*.

Some of these final bonuses may be zero, typically where the sample *asset share* is less than the value of units held.

We may change final bonuses at any time in order to protect the fund and to ensure that all policyholders receive their fair share in both good times and bad times. There are no restrictions on the size of final bonus that we might pay or how much it might change from one period to the next. We might not pay any final bonus.

Final bonuses are NOT guaranteed in any circumstances.

Market value reduction

We may apply a *market value reduction* if you cash in or transfer your policy or if you cash in units on occasions described in your policy document. This is to ensure that the amount we pay you is not unfairly higher than the underlying *asset share* of the policy at that date and that the remaining policyholders in the fund are not unfairly treated.

For all business not taken out with *Police Mutual*, we compare the sample *asset share* with the sample value of the units held in the fund for each *quarterly pool*. If the sample *asset share* is lower than the sample value of the units held in the fund for each *quarterly pool*, we may declare a *market value reduction* for this *quarterly pool*.

For *Police Mutual* business the approach is similar but uses actual policies instead of samples and *market value reductions* are calculated for each policy instead of in *quarterly pools*.

We regularly check these factors and make a change if needed to protect the fund and ensure that all policyholders receive their fair share in both good times and bad times. There are no restrictions on the size of the *market value reduction* that we might apply or how much it might change from one period to the next.

We will not apply *market value reduction* factors in the circumstances specified in your policy document or schedule.

Some examples of these circumstances include:

- at the pension date originally specified
- on death
- cashing in units in a with profits ISA taken out before 6 April 2001.

Please check your policy document to see which circumstances apply to your policy.

We will not apply a *market value reduction* unless it is justified to ensure fairness.

6 What is smoothing and how do you apply it?

Smoothing is one of the main features of of with profits business that we have to consider when determining the payout for a with profits policy. It is one of the key ways in which we can be fair to all policyholders.

The fund invests in a range of assets and the value of these goes up and down, sometimes significantly, over time.

We try to add bonuses in a way that protects policyholders to some extent from temporary ups and downs of the investments held by the fund.

For all business not taken out with *Police Mutual*, our current *smoothing* approach is to only change our bonus rates when the value of the fund's investments has changed by more than a set amount. This means that bonus rates could stay at the same level for many months even when the value of the fund's investments is going up and down.

For *Police Mutual* policies, *smoothing* is applied using a smoothed *asset share*. A smoothed investment return is used which is updated weekly.

Although bonus rates may go up or down, or we may decide not to announce a bonus at all, they will usually be more stable than the returns on the investments held by the fund.

Although we use it to reduce the impact of changes in investment returns, *smoothing* can't fully protect your investment. This is particularly the case following, for example, long periods of poor investment returns or sudden large market falls. When these happen we are likely to reduce final bonuses and/or apply *market value reductions*. In these situations the amount of *smoothing* may be reduced or even removed.

We aim for the effect of *smoothing* to cancel itself out over the long term. This means that, in the end, the amounts we hold back in good times should offset the amounts required in bad times.

We aim to be consistent between different types of policyholder (for example people who hold life or pension policies) and policyholders leaving the fund today and those that will leave in the future.

Smoothing protects the financial interests of all policyholders remaining in the fund.

7 How do you decide how much to pay me if I cash in or transfer my policy?

If you cash in some or all of the units allocated to your policy or transfer your policy, we need to work out how much to pay you in order to be fair to you and to those remaining in the fund.

We may pay a final bonus in these circumstances but this is not guaranteed.

We may pay less than the value of units by applying a *market value reduction*. We apply this when the *asset share* for a policy is lower than the face value of units plus final bonus. The *market value reduction* ensures fairness between those policyholders who leave the fund early and those who remain.

Payments when you cash in or transfer your policy may be reduced to protect remaining policyholders and allow for expenses we have incurred that we have not managed to cover out of the premiums already paid.

The range in which we aim to target most payments when you cash in or transfer your policy as a percentage of *asset share* is 75% to 125%.

8 How do you decide the investment strategy?

Our investment strategy aims to obtain the best possible returns for policyholders while still making sure that we can pay all their guaranteed amounts.

We do this by investing mostly in a mixture of company shares, property, government bonds, other bonds and cash.

Usually the investments that provide the best long term return are also the most risky (for example company shares). We therefore invest some of the fund in investments where the return is guaranteed or more stable (for example government bonds).

Our investment strategy also takes into account:

- the size of the *estate* as a 'cushion' against bad times
- the expected return from each type of investment we hold, and
- the expected variability of the returns from each type of investment.

We 'match' certain types of guarantee with appropriate investments such as government bonds or cash. By 'match' we mean that we hold investments that move in a similar way and have a broadly similar period to run as the guarantee itself.

We have a committee that regularly reviews the proportions held in each of these types of investment. The committee must work within guidelines agreed in advance to achieve an appropriate balance of risks. The proportions change from time to time as a result of our investment decisions and changes in investment markets. However, we expect changes to be gradual. Each year we publish on our website royallondon.com the investment mix at 31 December for some example policies in each *sub-fund*.

9 How might your business activities affect my payout?

The fund undertakes a number of different business activities. These are only undertaken once we have taken suitable professional advice and are happy that the proposed business activity fits within the fund's risk guidelines.

We undertake these activities because we expect that the rewards from the activity will outweigh the risks. For example, we issue new policies in the fund in the expectation that the long term profits from issuing these policies will generate extra bonuses for our qualifying with profits policyholders. The risk is that the new policies turn out to be less profitable than we expected or unprofitable.

Some risks associated with business activities are unavoidable and we have to manage them carefully. For example there is the risk that the charges we make to cover our expenses may not be enough to cover our costs.

We may use the *estate* to invest in subsidiary companies of *Royal London* or in other businesses with the aim of generating profits. The risk is that these investments may make lower profits than we expected or make losses.

We manage these activities to produce as high a return as possible while keeping track of the risks that may arise and looking for opportunities to improve the profitability of the businesses. This key responsibility drives much of our regular internal reporting and planning.

10 What are the expenses and how do you charge for them?

The expenses broadly cover the set up costs, any commission paid, ongoing administration costs and investment management costs. The expense levels depend on the size and type of policy.

The way we charge for expenses also depends on the type of policy. For some policies we allow for expenses by reducing the *asset share* by the explicit product charges applied to the policy. For other policies we take a deduction from the *asset share* to cover our actual incurred expenses.

In each case the amount applied represents a fair proportion of the total expenses incurred in administering all policies, using generally accepted techniques.

Where a policy includes life cover we take the cost of this from the *asset share*.

We may make a charge to *asset share* to cover the cost of paying guaranteed amounts (for example the guaranteed unit value on your policy). We would determine this cost using generally accepted techniques.

Currently only policies taken out with *Police Mutual* have a guarantee charge applied.

11 What is the estate and how do you manage it?

So far we have only briefly mentioned the *estate* of the fund but it plays a very important part in managing with profits business. Reading this section will help you to pull together the information we have provided in the previous sections.

As *Royal London* is a mutual company, the *estate* is even more important as it represents the main source of capital that we have readily available to us to operate and develop the business to provide benefit to our *members* and other policyholders.

We decide the size of the *estate* and we use it to help us to manage the fund properly and support its operation. We use the *estate* to make sure that we have enough money in the fund to satisfy our *regulators*, develop the business, issue new non profit and with profits policies and carry out *smoothing*, for example.

The *estate* also gives us more freedom to invest the investments of the fund in company shares and property to provide higher growth over the long term. When the size of the *estate* is small we need to invest a higher proportion of the fund in more stable investments such as bonds or cash. Any exceptional costs which we decide should not be charged directly to with profits policyholders will be met from the *estate*.

The *estate* acts as a 'buffer' for with profits policies because it funds the business activities and receives the profits and losses on these activities instead of these being passed on directly to the with profits policies. We also use it to meet the cost of any guarantees and *smoothing* after taking off any charges made to policyholders for these.

We manage the size of the *estate*. If at any time it is more than we think we need, we may decide to reduce it by distributing some of the profits, for example by enhancing *asset shares*, or by announcing increased bonuses. If we think that it is not enough, we may hold back some profits and instead announce reduced bonuses and/or take extra charges from *asset shares*.

The fund contains different groups of policyholders with different rights and interests in the fund including policies which were formerly with *Police Mutual, Phoenix Life Assurance, Refuge Assurance, Scottish Life* and *United Friendly*. We aim to manage the fund to make sure that we treat all these different groups fairly.

12 How can I find out more?

Each June we report on how we have complied with the PPFM in the previous year and publish this on our website royallondon.com

Each year we publish on our website royallondon.com the investment mix at 31 December for some example policies in each *sub-fund*. When we send you a yearly statement, we will normally include information on the investment mix backing policies in your *sub-fund*.

If you have any questions, please:

Call us on **0345 050 2020** between 8am and 6pm Monday to Friday, unless it's a bank holiday in England.

Or

Write to:

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If you would like a copy of this document in large print, please call us on 0345 050 2020

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