A GUIDE TO HOW WE MANAGE THE PLAL WITH-PROFITS SUB-FUND

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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* that was previously with *Phoenix Life Assurance Limited (PLAL)*. This would include an Individual Savings Account (ISA) invested in with profits.

On our website we refer to this guide as Guide 7.

We refer to the *PLAL With-Profits Sub-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.

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1 Useful terms

Asset share

A notional share in the assets of a with profits fund that a *with profits policy* is deemed to have. It is calculated by accumulating the premiums paid into a policy at the *investment result* after deducting any expenses or charges not already allowed for in the *investment result*.

Bid price

The price at which the units in your policy are cashed in to pay a claim on your policy, for example at the end of the policy term, at the pension date or on death. For policies other than the *PLAL* flexible pension the *bid price* is around 5% lower than the *offer price* of the units. We use this difference to pay some of our expenses. For the *PLAL* flexible pension policy the *bid price* is the same as the *offer price* as we charge our expenses in a different way.

Investment result

The investment return credited to the *asset share* in any year. It is based on the returns earned by the investments in the fund after deducting an allowance for tax (where appropriate) and for relevant charges and expenses such as the annual management charge. There may sometimes be a deduction arising from the costs of guarantees. We explain the costs of guarantees under question 9.

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 invested 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 end of the policy term, at the pension date or on death. Please refer to your policy document for the circumstances that apply for your policy.

Offer price

The price at which you buy the units that we allocate to your policy.

Phoenix Life Assurance Limited

When Abbey National Life plc was sold to Resolution plc in 2006, it was renamed *Phoenix Life Assurance Limited. Phoenix Life Assurance Limited* was subsequently bought by Pearl Group and then by *Royal London.*

PLAL

Phoenix Life Assurance Limited.

PLAL With-Profits Sub-fund

The separate sub-fund within *Royal London* which holds the *with profits policies* previously with *Phoenix Life Assurance Limited*.

Regulators

The Financial Conduct Authority and the Prudential Regulation Authority.

Royal London

The Royal London Mutual Insurance Society Limited.

Smoothing

The way in which we reduce the impact on policyholder payouts of the variation (sometimes quite a large variation) in the *investment result*.

Unitised

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

With profits policy

A policy where some or all of the premiums are invested in a with profits fund. If only some of the premiums are invested in a with profits fund, we mean this part of the policy.

Working capital

The amount by which the value of the investments of the fund at any time are greater than the sum of the *asset shares* of all the policies in the fund and the costs of guarantees. We explain the costs of guarantees under question 9.

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 We will send you an updated copy of this guide if we make any significant changes.

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
- 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 *unitised with profits policy* is a contract between you and us. We use your premiums to buy units in the fund at the *offer price*. Depending on the type of policy you have, we may not invest the whole premium in units as we take some of it to pay our charges. When you cash in units in your policy the units are sold back to us at the *bid price*.

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

The bonuses

We aim to increase the value of your policy by adding bonuses. We may do this by adding a regular bonus. If we add a regular bonus, we do it by increasing the price of the units. We may announce that the rate of regular bonus is zero, as we did for most policies from 2003 to 2011.

We may pay a final bonus at the time you cash in some or all of the units in your policy.

You may cash in units before the set event or date in your policy, for example by cashing in or transferring your policy or taking your pension benefits before your pension date. If you do this, we may pay you less than the face value of the units by applying a *market value reduction*.

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

What is guaranteed?

The amount we guarantee to pay you on the set event or date in your policy document will usually be the face value of the units in the policy. The set event or date depends on the type of policy you have but some examples are:

- the end of the policy term agreed when you started the policy (the maturity date)
- when you take your pension benefits at the pension date you agreed when you started the policy, or
- the date of death if you die before the end of the policy term.

There may be other times when we will guarantee to pay you a minimum amount. Your policy may also contain a guaranteed minimum amount other than the face value of units payable if you die before the end of the policy term. Please refer to your policy documents to check what guarantees your policy provides and when they apply.

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 leave the fund. We may also pay you a final bonus. We may reduce the total value we pay you if you:

- cash in some or all of the units in your policy before the end of the policy term, or
- transfer it, or
- take your pension benefits before your pension date.

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. We calculate *asset shares* for specimen policies by applying the *investment result* each year to the amount invested in units.

We calculate specimen *asset shares* so that we can keep track of the relationship between the face value of units and your 'share' of the fund. This ensures that the bonuses we pay are fair across the whole range of *with profits policies.*

Specimen *asset shares* are simply a measuring tool. We use them to help us set bonus rates and we use *asset shares* in aggregate to assess the *working capital* within the fund.

We do not quote *asset shares* on individual policies.

We compare the specimen *asset share* with the face value of the units in the fund for the specimen policy relevant to your policy type.

If the specimen *asset share* is higher than the value of units in the fund for the specimen policy, we may pay a final bonus. However, the amount of final bonus we pay also depends on the amount of *smoothing* that we apply when we pay.

If the specimen *asset share* is lower than the value of units in the fund for the specimen policy, we may apply a *market value reduction*.

We aim to keep the actual payouts close to the specimen *asset share* but we apply *smoothing* to the amounts we pay either when your policy ends or if you die.

We explain *smoothing* under question 6.

The range in which we aim to target most maturity payouts as a percentage of *asset share* is 80% to 120%.

At any time we may change the way we determine how much each policyholder 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 although we could change the rate at any time. We may announce that the rate of regular bonus is zero, as we did for most policies from 2003 to 2011.

We usually announce the rates of final bonus once a year but we can change them at any time.

We may reduce payouts to protect the interests of remaining policyholders if, for example, investment conditions are bad. We may increase payouts if, for example, investment conditions are exceptionally good.

Regular bonuses

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.

A regular bonus increases the guaranteed benefit in situations where we cannot apply a *market value reduction*, but there may be years when we do not add any regular bonus.

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 are adding a regular bonus to policies, the guarantees get bigger and are more likely to cost the fund money. Different policies have different guarantees and some policyholders would benefit more than others. Sometimes it is fairer to have no regular bonus and to reflect the impact of the investment returns by changing final bonuses and *market value reductions*. This is what we did for most policies from 2003 to 2011.

Having no regular bonus does not mean that your policy value did not change. We still used the *investment result* to help us decide the amount of any final bonus or *market value reduction*.

Final bonuses

We may announce a final bonus. This is designed to increase what you get back from your policy if the regular bonuses we have added to your policy do not fairly reflect the specimen *asset shares* that we have calculated for your policy type.

We compare the specimen *asset share* with the face value of the units in the fund for the specimen policy for your policy type. We then 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 the 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. 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 early or if you cash in units. This is to ensure that the amount we pay you is not unfairly higher than the underlying *specimen asset share* of the policy at that date and that the remaining policyholders in the fund are not unfairly treated.

For the group of policies that best represents your policy we compare the specimen *asset share* with the face value of the units in the fund. If the specimen *asset share* is less than the face value of the units in the fund plus any final bonuses applicable, we may decide that a *market value reduction* is appropriate. By doing this for all groups of policies we determine a scale of *market value reduction* factors.

We usually review these factors every month although we may not change them at each review. We may change them at any time in order 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.

We will not apply *market value reduction* factors in certain circumstances specified in your policy document, for example:

- at the end of the policy term
- at the pension date, or
- on death before the end of the policy term.

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 features of with profits business that we have to consider when setting bonuses and determining the payout for a *with profits policy*. It is one of the ways in which we aim to 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. One year a particular investment may do very well, the next its value could fall sharply. The *investment result* can vary year by year and sometimes may be negative, ie a loss.

Smoothing can mean that the policy value does not move up or down as quickly as the changes in the *investment result*.

We also take into account the amount of *working capital* that the fund has when deciding how much *smoothing* to apply. In the last few years we have applied much less *smoothing*.

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 payouts but still pay more than *asset share*.

We aim for the effect of *smoothing* to cancel itself out over the long term. This means that, over time, the amounts held back in good years should equal the amounts required in bad years.

When we are deciding how much to smooth, we aim to be consistent between different types of policyholder (for example people who hold life or pension policies) and between policyholders leaving the fund today and those that will leave in the future.

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

If you cash in some or all of the units in your policy or transfer your policy, we use the methods described under questions 4 and 5.

We aim to be fair to you and to those remaining in the fund so we may:

- pay out less than the face value of units by applying a *market value reduction*
- reduce the payout when you cash in or transfer your policy to allow for expenses we have incurred that we have not managed to cover out of the premiums you have already paid, if this is set out in your policy terms and conditions.

The range in which we aim to target most payouts when you cash in or transfer your policy as a percentage of *asset share* is 80% to 120%.

8 How do you decide the investment strategy of the fund?

Our investment strategy aims to make sure that, at the appropriate time, we can pay all the guaranteed amounts due to policyholders while trying to obtain the best possible returns.

These aims can conflict because usually the investments that provide the best long term return are also the most risky (for example company shares). In order to pay all the amounts promised we need to invest some of the fund in more stable investments where we are certain of a guaranteed return or where there is less variability in the return (for example government bonds).

We invest mostly in a mixture of government and other fixed interest bonds, company shares and cash. We may also invest in property but at the moment we have no investments in property.

We also invest in a set of 'fund protection assets' designed to cover the cost of guarantees in the fund. These are special investments whose value changes with the overall level of the stock market and as interest rates change. We explain these assets in more detail under question 9.

In addition to the items described above, we also take into account:

- the regulatory requirement to hold a certain amount of *working capital* as a 'cushion' against bad times
- the expected return from each type of investment we hold
- the expected variability of the returns from each type of investment.

A typical mix of investments might be to have about half the fund in fixed interest investments, about a third in company shares in the UK and overseas and the rest in cash and other investments. The actual mix at any time might be different. We usually aim to share in the overall movement of the market, rather than choose individual stocks.

Each year we publish on our website royallondon.com the investment mix of the fund at 31 December.

9 How might your business activities affect my payout?

The fund is closed to new business so this limits the types of business activities that can affect it directly. The business risks that remain in the fund are mainly in respect of guarantee costs.

Guarantee costs can occur if a policy is cashed in to pay a claim at a date when a guarantee applies and we cannot apply a *market value reduction*. If these guarantees mean that we cannot apply a *market value reduction* when we otherwise would, the guarantee costs the fund money.

The fund's expected guarantee costs have reduced significantly since 2011, particularly in respect of its with profits bonds.

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

The expenses broadly cover the costs of setting up your policy, any commission paid and ongoing administration and investment management costs. The expense levels depend on the size and type of policy. The expenses we use when we calculate the specimen *asset shares* are the actual expenses for the various specimen policy types.

We take some of the expenses into account by deducting them from the premium that we use to calculate the specimen *asset share*. We also deduct an annual management charge when calculating the *investment result* that we use to calculate the specimen *asset share*.

If your policy includes life cover, ie a lump sum payment if you die, we may make a deduction from the *asset share* for the cost of this.

11 What is working capital and how do you manage it?

The *working capital* of the fund plays a very important part in managing with profits business. It is the amount by which the assets of the fund are greater than the amounts already promised to policyholders by way of guaranteed amounts and the face value of units and bonuses at any time.

We will meet from the *working capital* any exceptional costs that we decide we should not charge directly to with profits policyholders. The *working capital* gives us some additional freedom to invest the assets of the fund in riskier assets with the aim of providing higher growth over the longer term.

The *working capital* is also used to meet the cost of any guarantees and *smoothing* after deducting any charges made to policyholders for these items.

We intend, over time, to distribute the *working capital* to with profits policyholders in a fair manner so that we have distributed all of it when we pay the last policy. To set the level of any such distribution we decide how much *working capital* the fund should have at any point.

If we think that the fund has too much *working capital* at a particular date, we may increase the *investment result*.

If we think that the fund does not have enough *working capital* at a particular date, we may reduce the *investment result.* If this isn't sufficient, we may also reduce *asset shares*.

We do not expect that the fund would have a shortage of *working capital* that would mean we had to reduce *asset shares* by more than 5%. However, if this did happen, we would contribute to the cost.

12 How can I find out more?

Each June we will 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 of the fund at 31 December.

If you have any questions, please:

Call us on **0345 741 3002** between 9am and 5pm Monday to Friday, except bank holidays.

Or

Write to:

Royal London
301 St Vincent Street
GLASGOW
G2 5PB

If you would like a copy of this guide in large print, please call us on 0345 741 3002

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