A guide to how we manage our with profits 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 an *Ordinary Branch conventional with profits policy* that was taken out with *Refuge Assurance* or *United Friendly* before 1 January 2001. 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 2.

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.

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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) 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 enhancements to *asset share*. We also take off a *transfer* to the estate from the asset shares of policies taken out with *Refuge Assurance* and *United Friendly*.

Co-operative Insurance Society

Co-operative Insurance Society Limited.

Conventional with profits policy

A type of with profits policy where payment of premiums guarantees an amount in the future.

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.

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*, *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.

RAIB sub-fund

The *sub-fund* into which *Refuge Assurance Industrial Branch* with profits policies were transferred.

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* that are not held in the *UFIB sub-fund*, the *RAIB sub-fund* or the *UFOB sub-fund*.

RLCIS

Royal London (CIS) Limited - the name given to *Co-operative Insurance Society* following its acquisition by *Royal London*.

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 *RLCIS* policies were 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* and *United Friendly* and non profit policies transferred from *Phoenix Life Assurance* and *Scottish Life*.

The with profits policies are held in four *sub-funds*: the *RL open fund*, the *UFIB sub-fund*, the *RAIB sub-fund* and the *UFOB sub-fund*.

The with profits policies transferred from *Scottish Life* are in a separate fund, the Scottish Life 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 *RLCIS* 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 (sometimes quite a large variation) in the returns earned year on year by the fund.

Sub-fund

The *Royal London with profits fund* has four *sub-funds*: the *RL open fund*, the *UFIB sub-fund*, the RAIB *sub-fund* and the *UFOB sub-fund*.

Transfer to the estate

This transfer 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*.

UFIB sub-fund

The *sub-fund* into which *United Friendly Industrial Branch* with profits policies were transferred.

UFOB sub-fund

The *sub-fund* into which *United Friendly Ordinary Branch* with profits policies were transferred.

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.

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. In return for the premiums that you promise to pay us, we will promise to pay you a guaranteed amount. We add bonuses to this guaranteed amount to form the total payment that you may expect to receive from your policy.

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.

The guaranteed amount

The guaranteed amount we promise to pay you may be:

- one lump sum payment (a sum assured)
- a series of payments (a pension).

We will pay the guaranteed amount on the set event or date in your policy schedule. If the guaranteed amount is a series of payments, we will pay the first of the series on this date. The set event or date may be:

- the end of the policy term, as agreed when you started your policy (the maturity date)
- when you access your pension fund from your 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 a minimum amount. Please refer to your policy documents for details.

The bonuses

We aim to increase the guaranteed amount by adding annual bonuses throughout your policy's term. We normally add annual bonuses every year. We may also pay interim bonuses on claims between annual bonus dates.

We may also pay a final bonus when we pay you the guaranteed amount and annual bonuses. If you cash in or transfer your policy or stop paying premiums early, we may pay you a reduced amount of the bonuses you would have received had you kept your policy until the end of its term.

There are more details on the bonuses we pay under question 5.

4 How do you decide how much to pay me?

The amount we pay you is made up of a guaranteed amount plus any annual bonuses we have added to your policy. We may also pay you a final bonus.

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 on the set event or date in your policy schedule.

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), the cost of providing benefits and guarantees to the policies and a *transfer to the estate*.
- Then we allow for the investment returns earned by the investments backing the policy each year. Until late 2009 the investment returns were the same for all policies in the fund. Since 1 January 2010 the investment return we allocate varies according to the *sub-fund* the policy is in.

We also include any enhancements we have made.

We calculate *asset shares* so that we can keep track of the relationship between the amounts we pay you and the investments available in the *sub-fund* for your policy. 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 them to set bonus rates and to assess the size of *estate*. We do not quote *asset shares* on individual policies.

For the group of policies that best represents your policy we compare their *asset shares* with the guaranteed amounts and annual bonuses that we have already promised to pay. We will pay you at least the guaranteed amount providing you have paid all the premiums due under your policy.

If the asset share is higher than the amount we have already promised, we may pay a final bonus. However the amount of final bonus we pay also depends on the amount of *smoothing* that we apply at the time we pay.

We apply *smoothing* to the amounts we pay over and above the guaranteed amount to make sure that we pay your fair share of the fund when your policy ends. We explain *smoothing* under question 6.

The range in which we aim to target most maturity values as a percentage of *asset share* is 80% to 130%.

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 bonuses once a year. We may do this more often if 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.

Annual bonuses

We announce annual bonuses that increase the guaranteed amount of your policy gradually over the policy's lifetime. Once added, an annual bonus becomes part of the guaranteed amount and cannot be taken away. However we will probably reduce the guaranteed amount and the annual bonus added if you cash in or transfer your policy or stop paying premiums early.

We decide annual 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 economic and investment conditions and the outlook for the future.

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

We may announce different annual 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 or policies with different guaranteed amounts).

We try not to change the amount of annual bonus we announce too much from year to year.

Interim bonuses

We may also pay an interim bonus on claims on policies taken out with *Refuge Assurance* between annual bonus dates to make up for some or all of the expected annual bonus that the policy may have earned since we announced the last annual bonus. We determine interim bonuses in the same way as annual bonuses and there are situations when we might not pay any interim bonus.

Final bonuses

We may also announce a final bonus. We do this to increase what you get back from your policy if the annual 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 the group of policies that best represents your policy we compare their *asset shares* with the guaranteed amounts and annual bonuses that we have already promised to pay. 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 *asset shares* are less than the guaranteed amounts.

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.

We may announce final bonuses more often than once a year to make sure every policyholder receives their fair share of the fund.

Final bonuses are NOT guaranteed in any circumstances.

6 What is smoothing and how do you apply it?

Smoothing is one of the main features of with profits business that we have to take into account 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. One year a particular investment may do very well, the next its value could fall sharply.

We try to add bonuses in a way that protects policyholders to some extent from large falls in the investments held by the fund. Instead of adding big bonuses in good years and small or no bonuses in bad years, we try to smooth them out. So we hold back some of the investment gains earned during good years and release them as bonuses when returns have been poorer or seem likely to get poorer or when the fund has made a loss.

Before we announce the bonuses, in order to decide how much *smoothing* to apply, we will:

- look at how large the *estate* is in comparison with the target amount we would like to have to develop the business (for example for issuing new policies)

- consider how much annual bonus we should announce and how much this bonus will cost, and
- look at how the payouts on recently maturing policies compare with their *asset shares* and whether they are bigger or smaller.

Although bonus rates may go up or down, or we may decide not to announce a bonus at all, they will usually be much 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 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 we hold back in good years should offset the amounts required in bad years.

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. We still apply *smoothing* to policies that are cashed in or transferred early or where we stop receiving premiums early, but not as much.

For historic reasons some *Refuge Assurance* policyholders are receiving enhanced payouts that are above the *asset shares* of those groups of policies.

The over-riding aim of our *smoothing* policy is to ensure that all policyholders receive their fair share of the fund.

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 or transfer your policy or stop paying premiums early, we need to work out how much to pay you in order to be fair to you and to those remaining in the fund.

Policyholders who cash in or transfer their policies or stop paying premiums early will not pay all the premiums they agreed when they started their policies. We must take account of this premium shortfall and of the fact that we may be paying a lump sum earlier than we had planned.

Payments when you cash in or transfer your policy or stop paying premiums early will normally be less than guaranteed amounts. This is to protect remaining policyholders and allow for expenses we have incurred that we have not managed to cover out of the premiums already paid.

We will calculate payments in these circumstances, or following any alteration to the original guaranteed amount, using methods which allow for our expenses and the early payment of the guaranteed amount. We may change these methods from time to time to ensure fairness to all policyholders.

We may pay a final bonus in these circumstances but this will usually be at a rate that is lower than you would normally get if you kept your policy for its full term and continued paying premiums. We may not pay any final bonus at all.

The range in which we aim to target most payments when you cash in or transfer your policy, or stop paying premiums early, as a percentage of *asset share* is 80% to 130%.

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).

Until late 2009 we managed the fund as a single collection of assets. All policies in the fund were invested in the same asset mix and received the same investment return.

On 1 January 2010 we changed our investment strategy so that each of the four *sub-funds* now has its own collection of assets. The asset mix in each *sub-fund* may be different as it will depend on the mix of policies in the *sub-fund*. Your policy is in the *RL open fund* (policies taken out with *Refuge Assurance*) or the *UFOB sub-fund* (policies taken out with *United Friendly*).

In addition, for each policy we gradually reduced the proportion invested in company shares and property and increased the proportion invested in government and other fixed interest bonds and cash as the policy approached the end of its term.

We did this to invest in more stable assets towards the end of the policy term. However, given that interest rates have been at all-time low levels and many of the policies remaining in the fund don't have fixed maturity dates, we have changed this approach.

From 2018 onwards we have moved back to a single investment mix. Your policy is still invested in a wide range of assets but the investment mix will no longer change as you approach the end of your policy.

We still take into account:

- the size of the *estate* in each *sub-fund* 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 by each *sub-fund*. 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*.

Policies taken out with Refuge Assurance

Regular premium pension policies taken out before 1 October 1992 and parts of policies paid by single premiums are now invested entirely in government bonds, other bonds and cash.

Policies taken out with United Friendly

Regular premium policies made paid up before 1 January 2010 are now invested entirely in government bonds, other bonds and cash. If your policy is 'paid up' it means that you can't pay any more premiums into it.

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 writing that business will generate extra bonuses for our with profits policyholders. The risk is that the new policies turn out to be less profitable than 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 with profits policies covered in this guide do not have explicit charges. Instead, we take account of the expenses of administering the policies and other charges when we decide the bonuses.

The expenses we charge to *asset shares* broadly cover the set up costs, any commissions paid, ongoing administration costs and investment management costs. The expense levels depend on the size and type of policy.

We take off the cost of risk benefits from the *asset shares* where these are included in the policy. Examples of 'risk benefits' are life cover (payments on death) or terminal illness cover (payments on diagnosis of a serious life threatening illness).

We may make a charge to *asset share* to cover the cost of paying guaranteed amounts (for example the guaranteed sum assured plus annual bonuses we have already announced). We would determine this cost using generally accepted techniques.

Currently we make no charges for guaranteed amounts on any policies covered in this guide.

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

So far we have only briefly mentioned the *estate* 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 *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 formerly with *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.

As a result of the transfer of the *Ordinary Branch* policies of *United Friendly* it was agreed that this group would have its own separate *estate* to be used to manage the policies in this group and to be distributed to them over time. These policies also share in the *estate* of *Royal London*.

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*. If 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.

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