PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT (PPFM)

The RLCIS OB & IB Fund

31 December 2016

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Other than the headings, certain words and expressions appear in **bold** and have a specific meaning, which is explained in the Glossary.

If legislative or regulatory requirements or the terms of the **Transfer Scheme** conflict with this document then those requirements or terms will override the contents of this document.

In this document the following words have a specific meaning:

• fund	the RLCIS OB & IB Fund;
• with-profits policy	a type of policy under which a policyholder shares in some or all of the profits and losses of a with-profits fund;
• we, us, our	The Royal London Mutual Insurance Society Limited, 55 Gracechurch Street, London, EC3V 0RL; Registered in England and Wales number 99064; and
• you, your	a with-profits policyholder in the fund.

Section A

A1. Introduction

The Royal London Group consists of The Royal London Mutual Insurance Society Limited ("Royal London") and its subsidiaries. Royal London is the UK's largest mutual life insurer with around six million policyholders. Its businesses offer pensions, life assurance, savings and investment products and provide investment management services. Products are distributed through financial advisers and direct to customers.

On 31 July 2013 Royal London completed the acquisition of Co-operative Insurance Society Limited from Co-operative Banking Group Limited. Following the acquisition Co-operative Insurance Society Limited was renamed Royal London (CIS) Limited. On 30 December 2014 the Long Term Business Fund of Royal London (CIS) Limited was closed to new business and transferred under a Court approved **Transfer Scheme** to a new sub-fund (the "Royal London (CIS) Sub-Fund") of the Royal London Long Term Fund.

The Royal London Long Term Fund consists of the Royal London Main Fund, which is open to new business, and the following four sub-funds which are all closed to new business:

- the Scottish Life Closed Fund;
- the PLAL With-Profits Sub-Fund;
- the Royal Liver Sub-Fund; and
- the Royal London (CIS) Sub-Fund.

The Royal London (CIS) Sub-Fund consists of the following three sub-funds:

- the RLCIS OB & IB Fund;
- the RLCIS With-Profits Stakeholder Fund; and
- the RLCIS With-Profits Pension Fund.

This document relates only to the RLCIS OB & IB Fund.

A2. What are the Principles and Practices of Financial Management?

The Principles and Practices of Financial Management ("PPFM") are the standards we apply to the management of our with-profits business.

This document sets out the Principles and Practices of Financial Management that apply to the RLCIS OB & IB Fund. We have produced separate PPFM documents which describe how we manage the RLCIS With-Profits Stakeholder Fund and the RLCIS With-Profits Pension Fund. Please contact us if you would like copies of any of these documents. All of the current versions of these documents, together with the PPFM documents for the Royal London Main Fund and its other sub-funds, are published on our website (www.royallondon.com).

In sections A3 to B4 of this document, the principles are shown in boxes with the rest of the text being the practices.

Principles

The principles of financial management are the high-level standards we follow when managing the fund. They describe how we will meet our duties to you as an investor in a with-profits fund and how we will respond to changes in the business and economic environment in the longer term.

We do not expect these principles to change often. However, if we intend to change any of the principles, we will normally tell you, in writing, at least three months before the proposed changes come into force. In certain circumstances, we may be able to obtain from our **Regulator** permission to notify you in a different way or with a shorter notice period.

Practices

The practices of financial management are the detailed methods that we use to ensure that we meet the principles. They represent the current approach we use to manage the fund and to respond to changes in the business and economic environment in the shorter term.

As a result, the practices may change as our circumstances, financial management techniques, the business and regulatory environment and other factors change. We will tell you, in writing or by some other means approved by the **Regulator**, about any changes we make to the practices. We may do this, for example, by including such information with your next yearly, or half-yearly, statement after the changes have been made.

How do we ensure that the PPFM is followed in practice?

Our Board of directors ("Board") is responsible for our overall direction and strategy, which includes establishing arrangements designed to ensure compliance with our PPFM. Each year, our Board will produce a report that sets out how we have complied with this PPFM. We will publish these reports on our website (www.royallondon.com) and give copies to our with-profits policyholders who ask for them.

In order to ensure that we are managing our with-profits business in accordance with the PPFM documents, we have appointed a **With-Profits Actuary** ("**WPA**") and a **With-Profits Committee** ("**WPC**"). The **WPA** advises the Board on PPFM compliance, treating with-profits policyholders fairly, areas of discretion in managing our with-profits business and potential conflicts of interest. One of the responsibilities of the **WPC** is to provide an independent view on whether we have managed our with-profits business in accordance with our PPFM documents.

A3. What is the Royal London (CIS) Sub-Fund?

The Royal London (CIS) Sub-Fund is the fund within which all the transactions relating to the long-term business that was formerly held within Royal London (CIS) Limited are made. These transactions include, amongst others, the payment of premiums, charging of expenses, provision of life cover and the payment of claims.

The Royal London (CIS) Sub-Fund consists of three sub-funds, namely the RLCIS OB & IB Fund, the RLCIS With-Profits Stakeholder Fund and the RLCIS With-Profits Pension Fund. The Principles and Practices of Financial Management for the RLCIS With-Profits Stakeholder Fund and those for the RLCIS With-Profits Pension Fund are contained in separate documents. This document covers the RLCIS OB & IB Fund which is referred to in this document as 'the fund'. All **non-profit** business written by Royal London (CIS) Limited was allocated to the fund.

The fund makes profits and losses and with-profits investors in the fund are entitled to share in the profits and losses of the fund through bonuses. The way in which bonuses are added to your policy depends on the type of with-profits policy that you have. This document describes the two types of with-profits business that are written in the fund: **traditional with-profits** and **accumulating with-profits**. **Traditional with-profits policies** include endowment assurances, whole life assurances, personal pensions and deferred annuity policies. **Accumulating with-profits policies** include Funeral Investment Plan policies, Funeral Plan policies and policies issued under the names Platinum Bond Plus and Platinum Plus.

Section A of this document describes how bonuses are determined from the profits and losses of the fund, and how the bonuses are used to determine the amounts payable. Section B provides more detailed information on how we manage the fund.

A4. What are the profits and losses of the fund and how are they shared?

We will apply the whole of the profits of the life assurance and pensions business written in the fund for the sole benefit of the life assurance and pensions policyholders. This includes the making of reserves with the aim of preserving the strength of the fund for the benefit of the life assurance and pensions policyholders.

Similarly, any losses incurred within the fund are borne either indirectly or directly by the policyholders, through a reduction in the working capital of the fund or through a reduction in their benefits.

Where profits and losses are shared directly with with-profits policyholders, they are allowed for when determining the amount of any bonuses which may be added to with-profits policies.

The RLCIS OB & IB Fund will not share in the profits arising in other funds of Royal London. Likewise Royal London's other funds do not have any entitlement to share in any profits arising in the RLCIS OB & IB Fund.

The profits and losses

Profits and losses may arise within the fund from a number of sources, the main ones being:

- the investment returns we obtain from the assets of the fund;
- the charges we make for expenses;
- the charges we make for tax;
- the provision of life and sickness cover;
- the payment of claims at levels that might be below or above the **asset share** (see section A5) of the policy;
- the costs of guarantees and options granted to with-profits policyholders; and
- business other than with-profits written in the fund and other **business risks**.

The tax charge (or credit) to the Royal London (CIS) Sub-Fund is generally calculated on the basis that it is a separate United Kingdom mutual life assurance company subject to taxation in the United Kingdom unless a different tax basis, approved by our **WPC**, our **WPA** and the **Royal London Actuary**, is considered fair and equitable by our Board taking into account the applicable circumstances.

Some profits and losses are shared directly with with-profits policyholders, while other profits and losses are allocated to or taken from the **working capital** of the fund.

For **Option 32** policies, the policy guarantees significantly exceed the **asset share**. In order to protect other policyholders from the risk of further costs arising within the fund to meet the guarantee costs, **Option 32** business has been reinsured. Consequently, **Option 32** policies will not generally share in the profits and losses of the fund. **Option 32** policyholders will continue to receive their guaranteed benefits.

For **traditional with-profits policies**, bonuses are generally of three types:

- annual bonuses, which may be added to policies each year and increase the guaranteed minimum amount that will be payable;
- interim bonuses, which may be added when a claim arises, in respect of the period since any annual bonuses were previously added; and
- final bonuses, which may be added when a claim arises.

For **accumulating with-profits policies**, bonuses are generally of two types:

- annual bonuses, which are expressed in terms of an annual rate, but which accrue daily; and
- final bonuses, which may be added when a claim arises.

For all policyholders of the fund, we aim to meet their reasonable expectations, treating different classes and generations of policyholders fairly. One aspect of fairness is the need to ensure that the interests of remaining policyholders are safeguarded against the impact of policyholders voluntarily leaving the fund. We aim to meet the reasonable expectations of policyholders who leave voluntarily but, in exceptional circumstances, taking into account the requirement to treat all policyholders fairly, we will make deductions from the amounts which would otherwise be paid on surrender or transfer (as described in section A8) in order to protect the interests of continuing policyholders. Any such deductions will accrue to the **working capital** of the fund.

A5. What methods are used to determine bonuses?

When determining the amounts of bonuses to be added to with-profits policies, our primary aim is to ensure that at all times the fund has sufficient assets to meet its **solvency** requirements and to provide an adequate level of **working capital**. Subject to this, we also aim to ensure, among other matters, that:

- the benefits payable under a policy reflect the premiums paid allowing for the financial and demographic experience of the fund during the period that the policy has been in force, including any charges made for mortality, expenses and the cost of providing guarantees, smoothing and/or capital support; and
- the benefits payable are smoothed from one generation of policyholders to the next.

The methods, assumptions and parameters we use to determine bonuses will be changed only in order to:

- improve their accuracy, particularly in relation to the methods used and the assumptions made about historic parameters;
- incorporate new financial management techniques;
- reflect changes in the financial or demographic experience of the fund as they occur;
- meet new regulatory or legislative rules or guidance; or
- ensure that the fund can meet its **solvency** and **working capital** requirements at all times.

Where premium rates, benefits, terms and conditions, charging structures or tax, legal or regulatory regimes differ between different groups of policies, or at times when there are major changes in financial or demographic conditions, we may introduce new **bonus series** in order to meet better our aims, as described above.

The methods, assumptions and parameters we use to determine bonuses may involve a degree of approximation, for example as a result of the pooling of experience. We consider that such approximations are appropriate given the aims of our methods.

Any material changes to our methods, assumptions and parameters will be approved by our Board although the Board may at its discretion delegate this responsibility.

The bonuses applied to with-profits policies are not determined individually for each policy. Instead, the experience of groups of similar policies is pooled, and those profits which are distributed as bonuses are shared across the group. Similarly, final bonuses are not calculated separately for each claim type, or for policies where premiums have stopped or been altered. Instead, a single scale of final bonuses is applied to all policies within a group.

Asset shares

The methods we use to determine bonuses include the calculation of **asset shares**. The primary methods we use to calculate **asset shares** are described below.

Traditional with-profits policies

For **traditional with-profits policies***,* **smoothed asset shares** are calculated as an accumulation of the following:

(i) the premiums paid over the term of the policy;
(ii) the investment returns achieved during the term of the policy after allowing for averaging over a number of years;

(iii) the charges made for expenses which have been apportioned to the policy;
(iv) if applicable, the cost of the life cover provided over the term of the policy;
(v) any charges to help meet the cost of providing guarantees, smoothing and/or capital support;
(vi) any allowance for profits and losses from policies that are surrendered or lapsed, or from **business risks**, that is apportioned to the policy; and
(vii) the tax and tax relief that has been apportioned to the policy.

Further details on items (ii) to (vii) are shown below.

(ii) Investment return

The investment return is taken to be the return achieved by the assets allocated to the category of policies in each year, allowing for taxation where appropriate. The return achieved is calculated from the income received and the change in value of those assets, between the start and end of the year, and allowing for other cashflows paid into and out of the fund.

The total assets of the fund are notionally apportioned between with-profits, **non-profit** and other types of business, in line with our **matching** approach. Assets are further notionally apportioned between different with-profits products to reflect the different asset classes backing each **policy type.**The resulting investment returns from such notionally allocated assets are used in the calculation of **asset shares** for each corresponding group of with-profits policies.

The investment return is averaged over a period of five years to determine the smoothed investment return. The smoothed investment return for a particular year is the average of the investment return for the previous two years, the investment return for the year itself and the investment return for the following two years.

Where an assumption needs to be made about the investment return expected to be made in future, we determine this investment return by reference to the current yield on medium to long-term UK Government securities. However, when the actual investment return for a future year becomes known, the smoothed investment returns for the previous two years are usually recalculated to allow for the actual returns achieved.

We may use a different approach to smoothing of investment returns to ensure that we continue to meet the aims of our methods. For example, relatively more smoothing was applied to the very volatile stock market returns achieved in the early 1970s.

(iii) Expenses

Traditional with-profits policies other than AVC policies

For such policies, the expenses allowed for in the **asset share** calculation are the charges made for expenses attributed to the **policy type**. Certain expenses, such as **compensation costs**, will not be included if they are being met from either the **working capital** or the Royal London Main Fund. Please see section B2 for further information on charges made for expenses on with-profits policies.

An amount is deducted for each year representing the charges made for managing the investments of the fund. These investment charges are expressed as a percentage reduction to the investment return.

AVC policies

For **AVC** policies, we allow for all expenses, other than investment charges, in the **asset share** calculation by the deduction of an annual management charge. Charges made for managing investments are allowed for in the same way as for other **traditional with- profits policies**.

(iv) Cost of life cover

For assurances, allowance is made for the estimated cost of providing the death benefit for each policy year during the term of the policy, using the past experience for that group of business.

(v) Cost of providing guarantees, smoothing and/or capital support

An annual charge may be made to enable the fund to meet the cost of providing guarantees, smoothing and/or capital support. We are currently charging all **traditional with-profits** contracts effected on or before 31 December 2002 an amount in respect of the guarantees provided. This charge is made by reducing the credited investment return by 0.5% per annum. We regularly monitor the effect of this charge and we may vary it in the future, for example, to reflect changes in the level of **working capital**.

(vi) Profits and losses from policies that are surrendered or lapsed, or from **business risks**, that are apportioned to the policy

Depending on the level of **working capital**, an allowance in respect of these profits and losses may be taken into account in calculating **asset shares**, for the purposes of determining final bonus scales for maturing policies, by an addition or reduction to the investment returns credited in respect of each calendar year. Allowance for such profits (known as "Miscellaneous Surplus") has been made in respect of policies maturing in past years by increasing the investment returns that are used to determine **asset shares** by the following amounts:

Calendar Year	**Miscellaneous Surplus Amount (%pa)**	
	Policies other than Personal pensions	**Personal pensions**
1994 – 2000	1.0	0.0
1989 – 1993	1.5	1.5
1984 – 1988	2.0	2.0
1983 and earlier	2.5	-

The amounts shown in the table above do not represent actual amounts of profit accruing from surrenders or lapses, or from other **business risks**. Instead, they provide a means of distributing part of the **working capital** to policies that are maturing, which may for example be appropriate if the level of **working capital** is more than we require to manage the business.

The allowance in respect of these profits and losses may be varied in future, for example to reflect changes in the level of **working capital**. Furthermore, there is no guarantee, nor should there be any expectation, that any allowance for such profits will be made in respect of policies maturing in future. In particular, should adverse movements occur in the levels of stock markets, in the yields obtainable from fixed interest investments, or in other factors affecting the level of **working capital**, the Miscellaneous Surplus shown in the table above may be reduced or removed altogether.

(vii) Tax and tax relief

The applicable tax rules differ according to whether the relevant policies are classed as life, pension, **ISA** or **PHI** business. Within the **asset share** calculations, tax rates are applied to investment income, capital gains and expenses in each year to reflect the rates of taxation that apply to each type of business. A lower tax relief rate is attributed to charges made in relation to sales and set-up expenses to allow for the deferral of any tax relief on these expenses.

Where eligible, a policy receives any Life Assurance Premium Relief ("LAPR") either through an increase in the guaranteed sum assured (some **Industrial Branch** policies) or through a decrease in the premium paid by the policyholder (other policies). For the former group of policies, differences between the rate of LAPR granted when the guaranteed sum assured was determined and the actual rate received are allowed for when determining final bonus rates.

Eligible pension policies attract tax relief in respect of premiums paid, subject to certain limits.

Any tax relief that we expect to obtain in respect of premiums paid is normally allowed for in the calculation of the **asset share** at the point in time at which the premium itself is payable.

Accumulating with-profits policies

For **accumulating with-profits policies**, the **asset share** is calculated as an accumulation of the following:

- (i) the premiums paid over the term of the policy;
- (ii) the investment return achieved during the term of the policy;
- (iii) management charges at rates defined in documentation issued to policyholders: the management charges may differ from the costs incurred in issuing and administering these policies;
- (iv) any charge for the cost of life cover provided on the policy;
- (v) any allowance for profits and losses from policies that are surrendered or lapsed or from **business risks** that are apportioned to the policy;
- (vi) any charge to help the fund meet the cost of any capital support;
- (vii) an assumed level of regular income withdrawal paid out; and
- (viii) the tax or tax relief that has been apportioned to the policy.

Asset shares are reviewed formally at least once a year, using the investment returns earned on the fund. Between formal annual reviews, changes in market indices are used to estimate the investment returns earned by the fund.

Asset share documentation

We document the methods, parameters and assumptions that are used when calculating **asset shares**, and the systems used to deliver these methods, including how these have been derived and any changes made.

Reviews of methods, assumptions and parameters

If we wish to make any material changes to the methods, assumptions and parameters used in determining bonus rates, we will document the changes together with an analysis of their effect on with-profits policyholders and present them to our **WPA** and **WPC** for advice before seeking Board approval. Our Board will consider the information set out before them in light of the effects the changes will have on the benefits of with-profits policyholders and the management of the fund before reaching a decision on whether to approve the changes. In some circumstances, for example where the changes are less material, the Board may at its discretion delegate this responsibility subject to taking into account the advice of the **WPA** and the **WPC**, as appropriate.

A6. How are annual bonuses determined?

We use annual bonus to pay out part of a policy's share of the profits of the fund, by increasing the level of guaranteed benefits. We set annual bonus rates with the aim of retaining part of the policy's share of the profits of the fund to be paid as final bonus.

We set the level of annual bonuses having regard to, amongst other factors, the level of guaranteed benefits, the fund's **solvency** position and the **working capital** of the fund. This means that we may sometimes apply no annual bonus to some or all policies.

We apply the same annual bonus rate across policies where we consider it appropriate to pool experience. Thus, for example, we may apply the same annual bonus rate across policies with similar:

- premium rates, or
- terms and conditions, or
- charging structures, or
- tax, legal and regulatory regimes.

How we set annual bonus rates

In deciding whether, and by how much, to change annual bonus rates we take into account a number of factors, including amongst others:

- the proportions of each asset type backing the policies;
- the current level of guaranteed benefits relative to **asset shares**; and
- the fund's **solvency** position and the level of **working capital**.

If all of the fund's assets were invested in risk-free investments, such as medium to long-term UK Government securities, and provided that declaring such bonuses would not materially affect the **solvency** position of the fund and the level of the fund's **working capital**, we could set annual bonuses based on the expected return from such investments.

However, in practice some of the fund's assets are invested in riskier assets such as shares and property. As a result, there is a risk that we will earn a lower rate of return on our investments than is required to meet the cost of paying annual bonus rates derived using risk-free returns. To allow for this risk, when we set annual bonus rates we project forward the **asset shares** of representative policies, allowing for the asset mix backing those policies and the risk associated with those assets, and compare the result with the current level of guaranteed benefits. This enables us to calculate by how much we can afford to increase the guaranteed benefits in future, and so determine appropriate levels of annual bonus to declare.

In doing this, we consider also the effect these levels of annual bonus will have on the fund's **solvency** position and level of **working capital**.

We also consider how our proposed annual bonus rates compare to our current annual bonus rates and as a result we may change annual bonus rates more gradually. We only limit changes in this way if this does not materially affect the fund's **solvency** position and the level of **working capital** of the fund.

Other factors

We set annual bonuses once a year, on 1 April, but we may change them more frequently if this is considered necessary to enable us to meet the aims of our methods.

When we review annual bonus rates, there is no maximum amount by which the bonus rates could change. In particular, this may result in no annual bonuses being declared for

some or all policies.

For each **bonus series**, the same annual bonus rates are applied to premium paying policies and to single premium, paid-up and altered policies.

Interim bonus rates are normally set at the same time as annual bonus rates and at the same rates. However, to protect the fund’s **solvency** position and level of **working capital**, it is possible that interim bonus rates could be changed more frequently than annual bonus rates or set at rates that are different to the rates of annual bonus.

A7. How are final bonuses and market value reductions (MVRs) determined?

When setting final bonus rates and **MVRs**, our aim is to pay to with-profits policyholders a fair share of the profits that have arisen in the fund over the lifetime of those policies which have not been distributed as annual bonuses and which we do not need to retain to meet the fund's **solvency** and **working capital** requirements.

When we determine final bonuses and **MVRs**, we aim to reduce the volatility of returns to policyholders through smoothing. Smoothing holds back part of the profits in some years, so that payouts can be higher than would otherwise be the case in other years when profits are lower. We may adjust the degree of smoothing of payouts to limit the cost of smoothing if this is required to ensure that the fund can meet its **solvency** and **working capital** requirements. We do not aim to make profits or losses from smoothing in the longer term.

We may use different approaches to smoothing depending on the type of policy, the type of claim and the methods used to determine benefits.

We will apply **MVRs** only to take account of changes in the underlying asset values or, in exceptional circumstances, to protect the **solvency** position of the fund.

We may change final bonus rates and surrender methods and factors to reflect changes in the profits and losses from our investments or to reflect changes in other profits and losses.

Our aim is to distribute the **working capital** to with-profits policyholders over the future lifetime of existing policies.

Different approaches to setting final bonus rates and to smoothing apply to **traditional with-profits policies** and **accumulating with-profits policies**. However, we do not apply a different smoothing strategy to sub-sets of these categories or to different generations of policyholders.

There is no specific time period over which we expect smoothing to be neutral but we do not aim to make profits or losses from smoothing in the longer term.

Traditional with-profits policies

We determine final bonus rates by taking into account a number of factors, including amongst others:

- the amount payable as guaranteed benefits including annual bonuses already declared;
- the **smoothed asset share** for a range of policies;
- the current level of payouts on similar policies reaching maturity; and
- the fund's **solvency** position and the level of **working capital** of the fund.

Final bonuses for maturing policies are normally set so that the total amount payable for such policies is equal to the expected value of the **smoothed asset share**. Using this approach, we set final bonus rates for other policies by reference to the final bonus rates for these policies. When we set final bonuses for maturing policies, our aim is to produce maturity payouts that, in at least 90% of cases, are between 80% and 120% of the **unsmoothed asset share** for such policies.

For pension policies, where the benefits are wholly or partly expressed in terms of a basic annuity to which bonuses may be added, the above comparison with **asset share** is performed by converting the current pension amount into an equivalent cash amount using annuity rates derived using current market interest rates and mortality assumptions.

Further smoothing of payouts

In addition to determining **smoothed asset shares**, we may smooth final bonus rates further by limiting the amount by which payouts for similar policies change from one year to the next. For deferred annuity contracts, a limit of approximately 30% is applied to year-on-year changes in payouts for similar policies of the same original term at the retirement date originally selected on the policy. A limit of approximately 20% is applied to year-on-year changes in payouts for similar policies of the same original term for all other types of policy.

We may smooth final bonus rates further when we change our methods, in order to phase in the change over a number of years.

The amount payable to with-profits policyholders is also smoothed because bonus rates are applied to policies making a claim before the next declaration of rates. As a result, the amount payable between declarations does not reflect any investment or experience fluctuations since the last declaration.

We do not set an overall limit to the accumulated cost of, or excess from, smoothing. However, we may adjust the degree of smoothing of payouts to limit the cost of smoothing if this is required to ensure that the fund can meet its **solvency** and **working capital** requirements.

Solvency and the level of working capital

We may limit final bonuses and hence payouts in order to protect the fund's **solvency** position and to ensure that the fund has a sufficient level of **working capital**. This may mean that, in some circumstances, final bonuses are set so that payouts represent less than 100% of **smoothed asset share** for some or all policies.

As the fund is closed, our aim is to distribute the **working capital** to with-profits policyholders over the future lifetime of existing policies. This is subject to there being enough **working capital** in the fund. The way we will distribute will be decided by our Board from time to time, but is most likely to be by an increase in final bonus rates. If **working capital** is distributed by other means, for example increases to **asset shares**, then we will reserve the right to remove these additions as a management action to protect the fund's **solvency** position.

Other factors

Final bonus rates will normally vary according to the number of years a policy has been in force and, if declared, are applied to all maturing policies (or policies reaching the retirement date originally selected) that have the same **bonus series**. This includes, amongst others, altered and paid-up policies and those single premium policies for which we do not calculate a separate **bonus series**. Separate **asset shares** are calculated for each group of policies that has a different **bonus series**.

If the level of guaranteed benefits exceeds the value of the assets held in respect of a category of policies when their final bonuses are being determined, final bonuses may be set to zero.

When final bonus rates are declared

We declare final bonus rates each year, normally with effect from 1 April, based on the **smoothed asset shares** for maturing policies projected to the expected maturity date. We also review final bonus rates, normally mid-way through the year, and may change them if necessary.

We may change final bonus rates more frequently as a result of changes in the economic environment. In particular, if payouts are expected to change by the maximum amounts of 30% in a year for deferred annuity contracts, or 20% in a year for all other types of policy, we may change final bonus rates more frequently than twice a year.

Accumulating with-profits policies

A **market value reduction (MVR)** is a reduction that may be made to the **plan value** when part or all of the plan is surrendered. We may apply an **MVR** to **accumulating with-profits policies** to ensure that those policyholders surrendering their plans do not benefit unduly at the expense of those policyholders who continue to hold their plans. We would do this to ensure that surrender values take account of changes in the underlying asset values, to protect the security of those policyholders who continue to hold their plans and to help ensure that they will receive an appropriate share of the profits and losses of the fund.

For **accumulating with-profits policies**, when we set final bonuses and **MVRs** our aim is to produce benefits that, in at least 90% of cases, are between 85% and 115% of **unsmoothed asset share** for such policies. Each time we set final bonuses and **MVRs**, we determine the percentage within this range for representative policies by taking into account a number of factors including, among others:

- the amounts payable in recent years compared to **unsmoothed asset shares**; and
- the **solvency** position of the fund and the fund's level of **working capital**.

For example, ignoring any distribution from the **working capital**, if benefits have recently been set at levels above 100% of **unsmoothed asset share**, we may need to set final bonuses or **MVRs** for a period so that benefits are below 100% of **unsmoothed asset share** so that in the longer term we do not make profits or losses from smoothing.

For **accumulating with-profits policies**, we review final bonus rates and **MVRs** at least twice a year. In determining final bonus rates and **MVRs** we may group policies whose start dates fall within a range covering several months.

For Platinum Bond Plus (a single premium with-profits bond), an **MVR** will not apply in respect of any premium where the application form for that premium was completed before 1 April 2000, and where the benefits provided by that premium are surrendered after at least 10 years. An **MVR** may, however, be applied in respect of any additional premium paid into the Platinum Bond Plus policy, where the application form for that additional premium was completed on or after 1 April 2000.

For Platinum Bond Plus, an **MVR** does not apply when income is withdrawn or in the event of a death claim. When determining payouts for Platinum Bond Plus policies, the calculation of the **asset share** for representative policies used to determine any **MVRs** or final bonuses allows for an average amount of income taken.

For Funeral Investment Plans and Funeral Plans, an **MVR** is applied only if a relatively large number of policies are being surrendered at the same time.

Solvency and the level of working capital

We may limit final bonuses or increase **MVR**s to reduce payouts in order to protect the fund's **solvency** position and to ensure that the fund has a sufficient level of **working capital**. This may mean that, in some circumstances, final bonuses are set so that payouts represent less than 100% of **unsmoothed asset share** for some or all policies.

As the fund is closed, our aim is to distribute the **working capital** to with-profits policyholders over the future lifetime of existing policies. This is subject to there being enough **working capital** in the fund. The way we will distribute will be decided by our Board from time to time, but is most likely to be by an increase in final bonus rates. If **working capital** is distributed by other means, for example increases to **asset shares**, then we will reserve the right to remove these additions as a management action to protect the fund's **solvency** position.

A8. How are bonuses applied when a payment is made on a policy?

a) Endowment assurance policies

Maturity and death claims

The amount payable on maturity is the with-profits sum assured plus any bonuses except that, for certain types of endowment assurance policy, the amount payable is compared to a minimum amount and, where higher, the minimum amount is paid. This minimum amount allows for limits on expense and mortality deductions as described in documentation provided to policyholders. In some cases, the effect of applying this minimum amount may be achieved by increasing the amount of final bonus that would otherwise be payable.

The amount payable on death is the with-profits sum assured plus any bonuses except that, for certain types of endowment assurance policy, the amount payable on death may be increased up to a specified minimum level, as described in the policy document. For a death claim, the final bonus rate is a proportion of the final bonus rate which would have applied if a policy of the same duration had matured at the same time. The proportion is determined by a formula which takes account of, among other items, the number of years for which premiums had been paid (or the duration up to the date of death) and the premium paying term (or term to maturity for single premium policies).

For some endowment policies with a longer term, the final bonus rate is a proportion of the final bonus rate which would have applied if a whole life assurance of the same duration had made a death claim at the same time.

Surrender claims

The methods, assumptions and parameters used to determine surrender values are reviewed from time to time to ensure that the amounts payable are appropriate given our aims. The methods, assumptions and parameters are documented.

We may amend the bases used to allow for changes in the underlying asset values and/or to allow us to meet better the aims of the methods.

When we set surrender bases, our aim is to produce surrender (or transfer) values that, for at least 90% of **traditional with-profits** endowment assurance and pension policies, are between 80% and 120% of **unsmoothed asset share**. We review surrender bases at least once a year. Over the longer term, we aim to set surrender values so that**,** ignoring any distribution from the working capital, the fund does not make a profit or loss from policies that are surrendered. However, in exceptional circumstances we may make deductions from surrender values in order to protect the interests of policyholders continuing in the fund.

For **Ordinary Branch** endowment assurance policies for which attaching annual bonuses have been surrendered prior to the final payment being made, the amount of bonus surrendered is normally taken into account when calculating the final payment.

Other points

Where applicable, surrender and maturity values produced by our methods are compared with any minimum amount that may apply to the policy and, where higher, the minimum amount is paid. In addition, during the early years of the policy for **Ordinary Branch** endowment assurance policies with policy numbers of 10,000,000 or more, the amount payable is subject to a minimum of a proportion of the premiums that have been paid. Where such minimum amounts apply, surrender and maturity values may exceed 120% of **unsmoothed asset share**.

b) Traditional with-profits whole life assurance policies

Death claims

For whole life assurance policies, the amount payable on death is the **guaranteed contractual amount** plus any interim bonuses and final bonuses. Final bonus rates are calculated as any positive excess of the smoothed asset share, for policies in force, over the guaranteed contractual amount plus any interim bonuses allowing for the probability of death occurring in the following year. For some policy classes, the final bonus rate is a proportion of the final bonus rate which would have applied if an endowment assurance policy of the same duration had matured at the same time. The proportion is determined by a formula which takes account of, among other items, the number of years for which premiums had been paid (or the duration up to the date of death) and the premium paying term.

Surrender claims

The methods, assumptions and parameters used to determine surrender values are reviewed from time to time to ensure that the amounts payable are appropriate given our aims. We may amend the bases used to allow for changes in the underlying asset values and/or to allow us to meet better the aims of the methods. Surrender values may be set at levels that are less than the underlying policy **asset shares**. In exceptional circumstances, we may also make deductions from surrender values in order to protect the interests of policyholders continuing in the fund.

The amounts payable on surrender will, to a limited extent, be smoothed by the partial inclusion in the calculation of the claim amount of any final bonuses. Some smoothing of the amounts payable on surrender can also arise through the methods, assumptions and parameters used. The degree of smoothing for any such claim depends on the method used, which itself varies according to the type of policy held and the type of claim made. The formulae and assumptions are not changed frequently and therefore the amount payable may not reflect fully the experience of the fund since the previous bonus declaration or since the formulae and/or assumptions were last changed.

For the purposes of determining surrender values, **Ordinary Branch** assurance policies are divided into two categories, referred to as ‘old’ and ‘new’ policies. New policies are those numbered 10,000,000 or more.

For old **Ordinary Branch** whole life assurance policies, the amount payable when a policy is surrendered is derived by applying certain factors to the sum assured, any annual bonuses or interim bonuses and to any final bonuses that may apply for death claims. Separate surrender factors are applied to the sum assured, to any annual or interim bonuses and to any final bonus.

The method for using the factors and the factors themselves are documented.

For policies for which attaching annual bonuses have been surrendered prior to the final payment being made, the amount of bonus surrendered is normally taken into account when calculating the final payment.

For new **Ordinary Branch** whole life assurance policies, the amount payable when a policy is surrendered is calculated as a percentage of an estimated current policy value. This current policy value is an approximation to the **smoothed asset share** used in setting bonus rates. However, during the early years of the policy, the amount payable is subject to a minimum of a proportion of the premiums that have been paid. The surrender value method and the factors themselves are documented.

For policies for which attaching annual bonuses have been surrendered prior to the final payment being made, the amount of bonus surrendered is normally taken into account when calculating the final payment.

For **Industrial Branch** whole life assurance policies, the amount payable when a policy is surrendered is derived using a formula applied to the sum assured and any bonuses. Our aim with this formula is to calculate an amount that is approximately equivalent to the value of the future benefits that are being given up after deducting the value of future premiums that will no longer be paid. The method for using the factors and the factors themselves are documented.

c) Pension policies with a minimum guaranteed cash amount at retirement

Retirement and death claims

For Personal Pension ("PP"), Free-Standing Additional Voluntary Contribution ("FSAVC"), Appropriate Personal Pension ("APP") (used to contract out of the State Earnings Related Pension Scheme or the State Second Pension) or **AVC** policies, the cash amount available at the retirement date originally selected on the policy is the guaranteed cash sum (protected payments cash sum for APP policies, basic lump sum for **AVC** policies) plus any bonuses. This cash amount is then available to purchase an annuity.

For PP, FSAVC, APP and **AVC** policies, the cash amount available on death, early or late retirement is based on the **guaranteed contractual amount** plus any interim bonus and any final bonus that may be added at that time. For deaths and early retirements, this amount is reduced to allow for any premiums that have not been received which were originally expected when calculating the retirement benefits, and for the shorter than expected investment period. For late retirements, the value is increased for any additional premiums that have been received and for the longer than expected investment period.

Transfer claims

When we set transfer bases, our aim is to produce transfer (or surrender) values that, for at least 90% of **traditional with-profits** endowment assurance and pension policies, are between 80% and 120% of **unsmoothed asset share**. We review transfer bases at least once a year. Over the longer term, we aim to set transfer values so that**,** ignoring any distribution from the working capital, the fund does not make a profit or loss from policies that are transferred out of the fund. However, in exceptional circumstances we may make deductions from transfer values in order to protect the interests of policyholders continuing in the fund.

Guaranteed annuity rates (GARs)

For certain PP, FSAVC and APP policies, we guarantee to pay a minimum rate of pension at the retirement date originally selected on the policy, in respect of all or part of the benefits. When a **GAR** applies, it is applied to the cash amount used to purchase an annuity at the retirement date, including all annual bonuses that have been declared and any final bonus applying at that time.

For PP and FSAVC policies, the **GAR** will normally apply only at the retirement date originally selected on the policy. However, we currently extend the application of the **GAR** to apply it on late retirement after that date. In this case, the **GAR** is applied at the

rate specified for the originally selected retirement date as set out in the policy's terms and conditions.

For PP and FSAVC policies, the **GAR** applies to single life annuities payable monthly in advance with a five year guarantee that do not increase once in payment. We currently extend the application of the **GAR** to all other single life annuities that do not increase when in payment. We apply the **GAR** to these other pension formats by applying the current pricing basis to calculate a minimum rate of pension for the alternative pension format with an equivalent value to the original **GAR**.

For APP policies, we currently extend the application of the **GAR** to retirements after age 60. For retirements from age 60 up to age 65, the **GAR** is applied at the rate specified in the terms and conditions for age 60. For retirements from age 65, the **GAR** is applied at the rate specified for age 65.

For APP policies, the **GAR** applies to a joint life annuity payable monthly in advance with a five year guarantee, increasing at 3% p.a. for benefits in respect of tax years up to and including 1996/1997 and at 5% p.a. for benefits in respect of tax year 1997/1998 and later. We currently extend the application of the **GAR** to annuities payable:

- at different frequencies;
- in arrears or advance;
- with escalation up to 3% p.a. for benefits in respect of tax years up to and including 1996/1997 and with escalation up to 5% p.a. for benefits in respect of tax year 1997/1998 and later;
- to single life annuities and to joint life annuities with a spouse's annuity of 100% or less of the APP policyholder's annuity; and
- with guaranteed periods of 10 years or less.

We apply the **GAR** to these other pension formats by applying the current pricing basis to calculate a minimum rate of pension for the alternative pension format with an equivalent value to the original **GAR**.

The cost of providing all **GARs** is currently being met by the **working capital**. Where the application of a **GAR** is not required by the policy terms and conditions but we currently apply one, we may in future no longer apply a **GAR** if we need to build up or protect the **working capital** of the fund or to protect the fund's **solvency** position.

Other points

The methods, assumptions and parameters for determining transfer, death, early and late retirement values are reviewed from time to time, to ensure that the amount payable is appropriate given our aims. We may amend the bases used to allow for changes in the underlying asset values and/or to allow us to meet better the aims of the methods. The methods, assumptions and parameters are documented.

Where applicable, the cash amount, or equivalent annuity if this is purchased from us, is compared with any other minimum amounts that may apply to the policy and, where higher, the minimum amount is paid.

These minimum amounts include, among others, those based on:

- the **special condition** applied in advance of the introduction of Stakeholder pensions;
- the **limit on expense deductions following** the introduction of Stakeholder pensions;
- a **pension review guarantee;** and
- a pension amount obtained by applying a minimum **guaranteed annuity rate (GAR).**

Where such minimum amounts apply, transfer and retirement values may exceed 120% of **unsmoothed asset share.**

d) Other pension policies where some or all of the guaranteed contractual amount is expressed as an annuity

Retirement and death claims

For these pension policies, the amount payable on the retirement date originally selected on the policy is the basic annuity and any cash sum allowed for under the terms of the policy, plus any bonuses.

For certain deferred annuity contracts, the amount payable on death is a return of premiums with interest, at the rate prescribed in documentation issued to policyholders. In the case of other pension and annuity policies, the amount payable on death is a cash amount calculated to be broadly equivalent to the **guaranteed contractual amount** and any interim bonus and final bonus added at that time.

For early or late retirements under deferred annuity contracts (other than **Option 32 policies**), a factor is applied to the basic annuity and any cash sum allowed for under the terms of the policy to reflect the shorter or longer investment period.

For **Option 32 policies**, the basic annuity is recalculated for late retirements to reflect the revised investment period. The amount payable on late retirement is the adjusted, or recalculated, basic annuity and cash sum allowed for under the terms of the policy plus any annual bonuses that have been added, any interim annual bonuses and any final bonuses. The amount payable on early retirement is based on the **smoothed asset share** of the policy. For early retirement within 5 years of the retirement date originally selected on the policy the amount payable will be smoothed into the **guaranteed contractual amount** that would be payable on the retirement date originally selected on the policy.

Where the benefits on retirement are taken in the form of a lump sum, the lump sum is determined based on the **smoothed asset share** of the policy subject to a minimum of the value of any **Guaranteed Minimum Pension** that applies. The value of any **Guaranteed Minimum Pension** is determined using annuity rates derived using current market interest rates and mortality assumptions.

Transfer claims

When we set transfer bases, our aim is to produce transfer (or surrender) values that, for at least 90% of **traditional with-profits** endowment assurance and pension policies, are between 80% and 120% of **unsmoothed asset share**. We review transfer bases at least once a year. Over the longer term, we aim to set transfer values so that, ignoring any distribution from the working capital, the fund does not make a profit or loss from policies that are transferred out of the fund. However, in exceptional circumstances we may make deductions from transfer values in order to protect the interests of policyholders continuing in the fund.

Other points

The methods, assumptions and parameters for determining transfer, death, early and late retirement values are reviewed from time to time, to ensure that the amount payable is appropriate given our aims. We may amend the bases used to allow for changes in the underlying asset values and/or to allow us to meet better the aims of the methods. The methods, assumptions and parameters are documented.

Where applicable, the amount payable on any claim is compared against any other

minimum amounts that may apply to the policy and, where higher, the minimum amount is paid. These include, among others, those based on:

- the **special condition** applied in advance of the introduction of Stakeholder pensions;
- the **limit on expense deductions** following the introduction of Stakeholder pensions;
- a **pension review guarantee**; and
- any **guaranteed minimum pension** (GMP).

Where such minimum amounts apply, transfer and retirement values may exceed 120% of **unsmoothed asset share**.

e) Accumulating with-profits policies

Our **accumulating with-profits policies** do not have a specified term and so there is no maturity date or maturity claim.

Except for Funeral Investment Plan and Funeral Plan policies, the amount payable to an **accumulating with-profits policyholder** on surrender is the **plan value** plus any annual bonuses which have accrued since any annual bonuses were previously added reduced by any surrender penalties that are described in the terms and conditions of the policy and adjusted for any final bonuses or **MVR** that may be added or deducted at that time.

For individual surrenders of Funeral Investment Plan and Funeral Plan policies, the amount payable on surrender is a return of the premiums paid less any initial charge and any **MVR** that may be applied at that time.

For Funeral Investment Plan and Funeral Plan policies where the funeral provider effects a bulk surrender of all the policies that it holds, the amount payable on surrender is the **unsmoothed asset share** less the cost of guarantees incurred at the date of surrender, subject to there being no adverse impact on remaining policyholders.

For Platinum Plus plans invested within an **ISA**, separate policies are established for each tax year. In the event of a partial encashment, these separate policies are notionally surrendered, in whole or part, starting from the earliest tax year until the encashment value has been provided. The future payout(s) will then be determined by reference to the remaining notional part or full policies.

The amount payable on death is specified in the policy terms and conditions as a prescribed percentage of the **plan value** at the time of death, where the **plan value** has been increased by any annual bonuses accrued since any annual bonuses were previously added and any final bonus. For Platinum Bond Plus policies, the amount payable is subject to a minimum of the total of all single premiums paid less any amounts paid out as income, reduced in proportion to any partial surrenders that have been made.

The final bonus rates used for death claims are the same as those used for surrender claims.

Section B
B1. The investment strategy of the fund

The fund's investment strategy is to achieve growth in the value of the fund by investing in a wide range of assets, for example UK and overseas shares, government and other bonds, property (which may include business premises) and subsidiaries, cash deposits and **derivatives.** A diversified range of assets is held to help reduce the risk to the value of the fund that would arise if most or all of the assets were invested in a single investment category.

An over-riding constraint on the fund's investment strategy is to ensure that at all times the fund has sufficient assets to meet its **solvency** requirements and to provide an adequate level of **working capital**.

We may notionally allocate the assets within the fund across different categories of policies, having regard to a number of factors such as the value and nature of policy guarantees. As a result, the proportions of each asset type allocated to the different categories of policy may vary by category.

We may hold **derivatives** and other similar investments in the fund in order to (for example):

- reduce the investment risk of the fund and hence protect its **solvency** position and the level of **working capital**, in particular to help meet the investment guarantees and options granted to categories of with-profits policies; or
- allow efficient portfolio management, for example to enable immediate changes to be made to the fund's mix of assets, if required; or
- allow appropriate **matching** of assets and liabilities in the case of structured products; or
- obtain exposure to specific asset classes through the use of **derivatives** in place of direct exposure.

We do not currently set limits on the fund's investment in assets that would not normally be traded, such as business premises and subsidiaries. The amounts of these investments are constrained only by the need for suitable diversification, return, liquidity and security and by our business operations and future business plans. The result of investment in assets that would not normally be traded is reflected in payouts in the same way as investment in other assets.

Investments in business premises and subsidiary companies would not normally be traded because of their importance in maintaining and developing the business. As part of our annual planning process, we will review the fund's investments in business premises and subsidiaries to consider, amongst other issues, their financial performance and continued need to our business.

Having regard to the advice from our **WPA** and **WPC**, as appropriate, our Board may decide to enter into any transaction between the Royal London (CIS) Sub-Fund and any other fund within the Royal London Long Term Fund or any other undertaking in the Royal London Group subject to such transaction satisfying the requirements specified in the **Transfer Scheme**. In particular, material transactions must be on commercial terms.

We currently set limits on the fund's exposure to any one company. These limits are reviewed regularly and our Board must approve any material changes to the limits.

Our Responsible Shareholding programme, which involves analysing and engaging with investee companies on corporate governance and a range of social, ethical and environmental issues, is an integral part of the fund's investment strategy. We consider such activity to be to the longer term benefit of the companies in which the fund invests

and hence of the fund itself.

Matching

The liabilities in respect of **non-profit policies** are closely **matched** with appropriate assets such as fixed-interest securities and **interest rate swaps**. This close **matching** is achieved by holding assets whose cashflows broadly correspond to the expected aggregate cashflows on the **non-profit business**. This **matching** is reviewed at least annually.

For with-profits business, in order to protect the fund's **solvency** position and the level of **working capital** we may closely **match** some or all of the guaranteed benefits with assets such as fixed-interest securities and suitable **derivatives**. The remainder of the assets are invested in a variety of asset classes, with the aim of obtaining a higher return for with-profits policyholders than would be obtained by investing solely in UK Government fixed-interest securities. The actual return obtained for with -profits policyholders will, however, depend on the actual performance achieved by the assets allocated to each category of policy.

When determining the allocation of assets to different categories of with-profits policy, we take into account, amongst other factors, the level of guaranteed benefits. This may result in our allocating different asset mixes to different types of business. We currently have different asset allocations for **accumulating with-profits business**, **traditional with-profits business** excluding **Table P policies** and **Table P policies**.

For **accumulating with-profits business**, investment guarantees are a significantly lower proportion of the total liabilities than for **traditional with-profits business**. So, generally, a relatively large proportion of riskier assets, such as shares and property, is held in respect of this business. We aim to hold approximately 55% to 75% of such riskier assets for this category of business, with property investments normally representing no more than 40% of the total equity and property assets.

In contrast, **traditional with-profits business** contains a relatively high level of investment guarantees and so a smaller proportion of riskier assets are generally held in respect of this business. We aim to hold approximately 40% to 60% of the assets backing **traditional with-profits business** in riskier assets such as shares and property, with property investments normally representing no more than 40% of the total equity and property assets. However, as described above, the actual exposure to such assets for a particular category of **traditional with-profits business** depends on the relative level of the guaranteed benefits associated with that category of business. In particular, in the case of policies which have a very high current level of policy guarantees compared with the level of **asset shares**, we may invest all the assets in cash, fixed-interest securities and **interest rate swaps**.

In the case of the fixed-interest securities allocated to **traditional with-profits policies**, separate allocations are made in respect of **Table P** and other policies. This is to enable us to remove most of the interest rate risk arising under such policies using **interest rate swaps**.

If investment markets fall significantly, or if the fund's **solvency** position is severely weakened, we may need to reduce the proportion of the fund invested in riskier assets, such as shares and property, and increase its exposure to less risky assets such as UK Government fixed-interest securities in order to ensure that there remains a sufficient level of **working capital** in the fund.

Assets within the fund that are held to meet the additional cost of guarantees under with-profits business or the cost of smoothing are invested in fixed-interest securities and

derivatives or similar notional investments. The **working capital** is currently largely invested in fixed-income securities.

We will regularly publish the asset mix backing different categories of policies. For example, this information is usually shown with yearly or half-yearly statements issued to policyholders and is also available on request.

Reducing investment risk

We hold a diversified range of assets to help reduce the investment risk that arises from holding any single type of asset.

To limit the fund's exposure to any one company we apply the following operating limits. For regulated credit institutions with a credit rating from Standard & Poor's and/or Moody's of A or above, the aggregate amount of exposure we will have to a single company (including shares and all other types of investments) should be less than:

- 3% of the total fund, or
- the value of the shares we hold in that company plus £200m, if this value is greater.

For other companies, the aggregate amount we will invest in a single company (including shares and all other types of investments) should be less than:

- 2% of the total fund, or
- the value of shares we hold in that company plus £100m, if this value is greater.

For all companies, we have a separate limit on the value of shares that we will hold in a single company. This limit is 5% of the fund.

Changes in the market value of the fund's investments may result in the operating limits being exceeded. For example, the value of the fund's investment in the equity of one company may increase over a very short period with the result that the fund's aggregate exposure to that company exceeds our normal operating limits.

We currently hold a range of interest rate **derivatives**, including **swaptions**, to help reduce the investment risk from our minimum **guaranteed annuity rates (GARs)**. These are held to help reduce the risk to the fund from future interest rates being lower than required to meet the **GARs**. From time to time we may also hold other derivatives, with the aim of limiting the risk to the fund of adverse market movements.

We use **derivatives** and construct similar, but notional, arrangements to protect the **solvency** position of the fund from investment risks in respect of other cashflows, such as variations in the value of future annual charges.

We may also invest in commodities, infrastructure financing or insurance related investments to provide credit diversification within the fund.

Other uses of derivatives and similar investments

We currently also hold **derivatives** and other similar investments in the fund in order to allow efficient portfolio management, for example to enable immediate changes to be made to the fund's mix of assets, if required and to obtain exposure to shares, government bonds and corporate bonds in place of direct exposure.

Business premises and subsidiaries

Investments in business premises and subsidiary companies would not normally be traded because of their importance in maintaining and developing the business.

The fund's investments in subsidiary companies are normally either:

- in companies that allow us to meet better the financial services needs of our long-term business policyholders; or
- in companies that are used for the purpose of holding other investments of the fund, such as investment properties or other types of asset.

For the purposes of determining the amounts payable to with-profits policyholders, these investments are valued in a manner consistent with other investments. Any buildings are valued in the same way as other property investments. Subsidiaries are usually valued on a 'look through' basis, i.e. by looking at the underlying net assets of the subsidiary company.

The value of these investments, relative to the size of the fund, is currently not large enough to constrain the investment freedom of the fund.

Investment strategy reviews

Before any investment is made in new or novel types of investments, we carry out a review and put any recommendations arising from the review to our Board for approval taking into account the advice from our **WPA** and **WPC**, as appropriate.

We will review the proportion of the fund held in each investment category at least annually.

B2. The charges made for expenses on with-profits policies

When setting the charges for expenses on with-profits business, our aim is to set charges that are at least sufficient to meet the expected costs incurred in selling and administering that business over its expected future lifetime. This will be done either through the allocation of an appropriate share of the costs incurred or by the deduction of charges as defined in documentation issued to policyholders.

When apportioning expenses we will allow for any limits on charges for expenses imposed by the terms and conditions or other documentation provided to with-profits policyholders.

At least annually we will review our costs and we may change how we allocate them if, for example, there are:

- changes to the way that expenses are analysed and measured;
- changes to the mix or volume of business (including with-profits and other types of business);
- new types of expenses, changes to the types of expense or one-off expenses;
- changes to industry practice, regulation, legislation or taxation rules; or
- decisions of the Court that affect the way in which we allocate expenses.

For **traditional with-profits policies**, the charges made for expenses are allocated to **asset shares** as part of the method used to determine final bonuses and some surrender and transfer values.

Prior to 1 August 2013 the charges made for expenses were those in relation to the costs and any charges arising directly from the management of the CIS Long Term Business Fund. These costs and charges comprised the expenses of selling and administering with-profits business including, amongst other factors, remuneration for sales representatives, amounts payable for investment management services and other administration costs such as those relating to establishing records, producing policy

documentation and complying with legislation and regulation.

Certain categories of expense, such as sales-related payments to sales representatives, could be attributed directly to the relevant class of policy. Other expenses, which could not be directly attributed to a particular class of policy, such as basic salaries for sales representatives, investment expenses or charges and other administration costs, were allocated on bases which were at least sufficient to meet the expected costs. Where appropriate, this included the allocation of a share of expenses among with-profits, **non-profit** and other types of business.

Some expenses, for example large one-off development expenses, were averaged over a number of years to reduce the fluctuations in levels of these expenses.

From 1 August 2013 the charges made for business as usual activities, such as those in relation to establishing records, producing policy documentation, collecting premiums and paying claims, are based on fees levied by the Royal London Main Fund as agreed between Co-operative Banking Group and Royal London as part of the terms for the sale of CIS to Royal London. Additional charges are payable from the fund to the Royal London Main Fund for costs of an exceptional nature and for investment management services.

Charges made for business as usual activities can be directly attributed to the relevant class of policy. Other charges made for expenses are allocated with the aim of attributing a fair proportion of such charges to each class of policy. Where appropriate, this may include the allocation of a share of charges made for expenses among with-profits, **non-profit** and other types of business.

Some charges made for costs of an exceptional nature, for example in relation to large one-off development expenses, may be averaged over a number of years to reduce the fluctuations in levels of these charges applied to **asset shares** although the full cost of such items would be charged to the fund as they arise, with the **working capital** initially meeting any cost that is not charged to **asset shares**. Other charges made for expenses are met from the **working capital** in the first instance. Should the **working capital** be unable to bear some or all of these charges, any shortfall will be met from the **asset shares** of with-profits policyholders.

Certain compensation costs are currently met from the **working capital** of the fund with other such costs being met from the Royal London Main Fund (see section B3).

For **accumulating with-profits policies**, subject to any externally imposed charge caps, the charges made for expenses are set to be at least sufficient to cover the costs incurred in issuing and administering these policies. Prior to 1 August 2013 such costs represent expenses arising directly from the management of the CIS Long Term Business Fund whereas from 1 August 2013 such costs relate to the fees and other expenses levied by the Royal London Main Fund in return for the policy administration, investment management and other aspects of the management of the fund. Any difference between the charges for expenses that are applied to **asset shares** and the costs incurred would be met from, or would add to, the **working capital** of the fund.

We regularly review the methods we use to determine the charges to be made for expenses. As a result, they may change from time to time so that we can be sure that they continue to be appropriate.

B3. The business risks associated with investing in the fund

We monitor regularly the level of **business risk** within the fund, and where considered necessary we will seek to take appropriate action to reduce risk exposure.

We will assess whether the level of **business risk** carried by the fund is appropriate by reference to the **solvency position** and level of **working capital** of the fund.

Shortfalls between the expenses incurred by the fund and the charges received by the fund in respect of long term business where policy charges are defined in documentation issued to policyholders, such as pensions business written in the RLCIS With-Profits Stakeholder Fund and the RLCIS With-Profits Pension Fund, will usually be met from the **working capital** of the fund.

As part of Royal London, the fund is indirectly exposed to **business risks** arising in the other funds of Royal London. Costs arising from those risks could be charged to the fund in exceptional circumstances.

The fund is exposed to **business risks** from a variety of sources. We monitor regularly the level of **business risks** within the fund as part of our standard risk management procedures, and where considered necessary we seek to take appropriate action to reduce risk exposure.

Major risks

We have identified what we believe to be the most significant of the **business risks** to the fund and these are set out below, along with the actions that have been taken to mitigate these risks. Each of the risks described can influence the amount and timing of the profits and losses that emerge in the fund. As stated elsewhere in this document, maintaining the fund's **solvency** position and **working capital** requirements is considered paramount, and we will seek to take appropriate action to minimise the potential impact of these risks

Longevity risks and guaranteed annuity options

A considerable proportion of the **traditional with-profits** pensions business written in the fund provides for policyholders to take their benefits in the form of an annuity at retirement and a relatively large proportion of the policies include a **GAR**. The cost of providing these benefits increases with improvements in longevity of annuitants and with reductions in interest rates, and these factors therefore represent an inherent risk to the fund. The cost of providing these benefits will be met in the first instance from the **working capital** of the fund. However, should the **working capital** be unable to bear some or all of this cost, any shortfall will be met from the **asset shares** of with-profits policyholders.

We have set up explicit reserves to allow for the cost of these benefits, and we regularly monitor these reserves and the associated interest rate and mortality assumptions. We also review the investment strategy in order to limit the exposure to changes in market conditions and we have purchased a series of interest rate **derivatives** including **swaption** contracts which help to provide protection against the risk that further falls in interest rates will increase the **GAR** liability.

In addition, some annuities are reinsured in order to protect the fund from the longevity risk arising from such business.

Other guarantees associated with with-profits policies

Most with-profits policies have some form of **guaranteed contractual amount**. They include guaranteed minimum amounts on maturity and death, as well as on surrender on certain defined events (such as on or after the tenth anniversary of the payment of a premium for certain Platinum Bond Plus policies, when no **MVR** can be applied).

Annual bonuses increase the underlying level of these guarantees. We try to manage this risk by limiting the build up of these guarantees, for example by applying annual bonuses over time at rates which we consider can be adequately supported by the financial resources of the fund (see section A6). In order to protect the fund's **solvency** position and the level of **working capital**, we may closely **match** some or all of the guaranteed benefits with assets such as fixed-interest securities and suitable derivatives (see section B1).

Investment risks

There are a number of types of investment risk. The most important are falls in equity/property values, changes in fixed-interest yields and defaults on corporate bonds. We attempt to manage these risks through the investment strategies we adopt, including (amongst other factors):

- the use of **derivatives** that partially hedge market risks;
- closely **matching non-profit** liabilities with **interest rate swaps** and fixed-interest assets of appropriate term;
- investing only in corporate bonds of appropriate quality; and
- managing the balance between the fund's exposure to shares and property and investment in assets such as fixed interest securities in a manner which we consider appropriate to support the levels of guaranteed benefits in the fund, given the other aims of our investment strategy.

These are discussed in more detail in section B1.

Expense risk

Apart from the risk of increased inflation, future expenses are to a relatively large extent determined by the fees levied by the Royal London Main Fund for business as usual activities which, ignoring inflation, are guaranteed for 20 years from 1 August 2013. From 1 August 2033, such fees will be reviewed at 5 yearly intervals by reference to those available at that time from an external provider of such services and to the relative costs of providing business as usual services to the Royal London Main Fund.

In addition, fees are levied by the Royal London Main Fund in relation to investment management services with such fees, when expressed as percentage of the size of the fund, being guaranteed for 5 years from 1 April 2011, and subject to constraints specified in the **Transfer Scheme** thereafter.

Fees for business as usual activities and for investment management services after the end of the guaranteed periods are not guaranteed.

The Royal London Main Fund may make additional charges to the fund to cover costs of an exceptional nature, as defined in the Transfer Scheme. Such exceptional costs may include, but are not limited to, those arising from the requirement to meet changes in legislation or regulation and those incurred in enhancing IT systems.

The level of fees and other expenses incurred by the fund is monitored on a regular basis. Shortfalls between the expenses incurred by the fund and the charges received by the fund in respect of long term business where policy charges are defined in documentation issued to policyholders, such as pensions business

written in the RLCIS With-Profits Stakeholder Fund and the RLCIS With-Profits Pension Fund, will usually be met from the working capital of the fund.

Potential compensation claims

We aim to provide a high level of service for our policyholders. Should any costs arise as a result of business within the Royal London (CIS) Sub-Fund having been mis-sold with an application form signed prior to 31 July 2009 or on or after 30 December 2014 they will be met in the first instance from the **working capital** of the fund. Should the **working capital** be unable to bear some or all of this cost, any shortfall will be met from the **asset shares** of with-profits policyholders. Any other compensation costs arising in respect of events prior to 31 July 2009 will be treated in a similar way.

Any compensation costs arising in respect of events on or after 30 December 2014, other than from certain operational events specified in the **Transfer Scheme**, will also be treated in a similar way.

Mis-selling costs in respect of policies sold within the Royal London (CIS) Sub-Fund with an application form signed on or after 31 July 2009 but prior to 30 December 2014, and any other compensation costs arising in respect of events during that period, will be met from the Royal London Main Fund. In addition, the Royal London Main Fund will meet any costs associated with certain operational events arising on or after 30 December 2014 as specified in the **Transfer Scheme**.

However, if, in the reasonable opinion of our **WPA**, the resulting allocation of any such costs would be materially unfair to either the Royal London (CIS) Sub-Fund or the Royal London Main Fund then our Board will review and determine (having regard to the advice of our **WPA** and our **WPC**) the appropriate allocation of those costs between the two funds.

Policy options and unit trust business

Although the fund is closed to new business, policyholders continue to be able to exercise any policy options under the terms and conditions of their policies. Such options may include the option to increase premiums to a with-profits policy or to take out a **non-profit** policy without needing to provide any evidence of health of the life assured. Generally such business will be written in the fund but, after taking advice from our **WPA** and **WPC**, our Board may decide to write **non-profit** business arising from such policy options in the Royal London Main Fund.

New and additional unit trust contributions can currently be made into one or more of the unit trusts which are administered by RLUM (CIS) Limited, an investment of the **working capital** of the fund. We regularly review the volume and mix of new unit trust business. To do this, we estimate the impact that such new business has on the fund's **working capital**. This allows us to plan what volumes and mix of new business are appropriate given the fund's level of **working capital**. We expect to continue to write new unit trust business provided that this is not expected to have a detrimental effect on the existing business within the fund.

We review the terms on which such business is written at least annually and, if necessary, more frequently in order to ensure, where possible, that these adequately reflect the risks undertaken by the fund. We also aim to ensure that for each type of contract the terms on which new business is written are sufficient to provide an adequate return on the **working capital** of the fund.

Investment in subsidiaries

Some of the assets of the fund are invested in a number of subsidiary companies. The fund therefore bears the risk that these subsidiaries will make losses or require further capital in the future. In particular, the fund bears the expense risk associated with its subsidiaries. As a result, if the subsidiaries are unable to meet the expenses incurred by them in full, the balance will in the first instance be borne by the **working capital** of the fund. However, should the **working capital** be unable to bear some or all of this cost, any shortfall will be met from the **asset shares** of with-profits policyholders.

Risks associated with other funds of Royal London

Aside from the expense risk associated with the RLCIS With-Profits Stakeholder Fund and the RLCIS With-Profits Pension Fund, the fund is indirectly exposed to **business risks** arising in the other funds of Royal London. Costs arising from those risks could be charged to the fund in exceptional circumstances.

Miscellaneous business risks affecting the with-profits business

Miscellaneous risks affecting the fund include, amongst others, risks related to mortality, regulation, legislation and taxation, as well as operational risk. We monitor and manage mortality risks through the use of appropriate underwriting and reinsurance arrangements. Operational risk is monitored and managed through our standard risk management framework with costs arising from operational issues being met from either the Royal London Main Fund or the **working capital** of the fund in accordance with the **Transfer Scheme** . Other miscellaneous risks, such as regulatory and legislative changes are largely outside our control, but we monitor and manage such risks where appropriate and possible.

Impact of risks on payouts

Generally, the financial effect of investment, expense and mortality risk, and of any charges made for guarantees, smoothing or the cost of capital, is applied directly in the calculation of **asset shares**. Apart from certain compensation costs and certain other costs arising from operational risks that are currently met from the Royal London Main Fund, the effect of other **business risks** is normally applied in the first instance to the **working capital**, in which case the profits or losses from these other **business risks** would not affect the calculation of **asset shares**. At present, no losses from these other **business risks** are being reflected in the calculation of **asset shares**.

However, should the level of **working capital** be insufficient or be more than we require to manage the business appropriately, an allowance for the effect of these other **business risks** may be made in the calculation of **asset shares** when determining final bonuses and some surrender and transfer values. There is no specific minimum value or scale above which profits or losses from these other **business risks** would be reflected directly in **asset shares**. Although we do not normally apply profits or losses from **business risks** directly to **asset shares** as they occur, in the event that it was necessary to allow for such profits and losses, there can be no guarantee that their effect on policyholders would be smoothed.

B4. The working capital of the fund

The overriding principle is that the Royal London (CIS) Sub-Fund is to be managed, so far as it is possible, within the limits of its own **working capital** so that it meets its **solvency** requirements under a range of adverse conditions.

If the Royal London (CIS) Sub-Fund is unable to cover its own **solvency** requirements then capital from the Royal London Main Fund, if available, would be used to help meet such requirements pending the taking of available management actions with the aim of ensuring that the Royal London (CIS) Sub-Fund can meet its own **solvency** requirements. A charge would be made to the Royal London (CIS) Sub-Fund in relation to such support from the Royal London Main Fund on terms specified in the **Transfer Scheme**.

If the Royal London (CIS) Sub-Fund is unable to cover its own regulatory liabilities then assets from the Royal London Main Fund, if available, would be transferred into the Royal London (CIS) Sub-Fund to help meet such requirements pending the taking of available management actions with the aim of ensuring that the Royal London (CIS) Sub-Fund can meet its own regulatory liabilities. The Royal London (CIS) Sub-Fund would be managed with the aim of repaying the assets with interest on terms specified in the **Transfer Scheme**, as soon as practicable, so that any financing from the Royal London Main Fund is temporary.

In exceptional circumstances where even after taking all available management actions, including taking a succession of management actions with the cumulative effect of reducing policyholder payouts to **guaranteed contractual amounts**, the Royal London (CIS) Sub-Fund is still not able to meet some or all of the **guaranteed contractual amounts**, then assets from the Royal London Main Fund, if available, would be transferred into the Royal London (CIS) Sub-Fund to help meet such **guaranteed contractual amounts**. The intention is that any amounts transferred to the Royal London (CIS) Sub-Fund from the Royal London Main Fund will be repaid, with interest on terms specified in the **Transfer Scheme**, as soon as practicable, so that any financing from the Royal London Main Fund is temporary (except in the extreme situation where no further action to reduce reliance on the Royal London Main Fund is possible).

The primary uses to which the fund's **working capital** may be put are to:

- ensure that the fund remains **solvent**;
- support **business risks**;
- support the fund's investment strategy with, for example, greater investment in more risky assets such as shares, property and corporate bonds;
- support smoothing of payouts;
- meet unexpected costs, including certain **compensation costs**; and
- meet other rights of policyholders.

We may hold back some profits if this is required to maintain a sufficient level of **working capital**. Conversely, if the level of **working capital** is more than we require to manage the business appropriately, we may share out additional profits to reduce the level of **working capital**. Where we share out such profits from the **working capital**, we will do so in an equitable manner by enhancing bonuses and/or **asset shares** in respect of those with-profits policies that are entitled to such profits over the remaining lifetime of such policies.

The **working capital** is not separately allocated to the different classes of business within the fund.

Having regard to the advice of the **Royal London Actuary** and our **WPA**, our Board may decide to cease to maintain the Royal London (CIS) Sub-Fund as a separate sub-fund in the Royal London Long Term Fund where the value of the assets of the Royal London (CIS) Sub-Fund falls below £500 million (with such amount adjusted on 1 January 2015 and annually thereafter in line with the Retail Price Index for the previous 12 month period) or such greater amount below which our Board considers the continued maintenance of the Royal London (CIS) Sub-Fund as a separate sub-fund is materially adverse to the interests of Royal London Main Fund policyholders and the cessation of the Royal London (CIS) Sub-Fund as a separate sub-fund is not materially adverse to Royal London (CIS) Sub-Fund policyholders or vice versa.

If the value of the assets in the Royal London (CIS) Sub-Fund falls below £100 million (with such amount adjusted on 1 January 2015 and annually thereafter in line with the Retail Price Index for the previous 12 month period) then the Royal London (CIS) Sub-Fund will cease to be maintained as a separate sub-fund of the Royal London Long Term Fund.

In the event that the Royal London (CIS) Sub-Fund ceases to be maintained as a separate sub-fund of the Royal London Long Term Fund, all of the policies, assets and liabilities allocated to the Royal London (CIS) Sub-Fund would be transferred to the Royal London Main Fund, with the value of any residual **working capital** of the Royal London (CIS) Sub-Fund being allocated to the eligible with-profits policies written in the Royal London (CIS) Sub-Fund in accordance with the requirements of the **Transfer Scheme**.

The **working capital** is currently used for each of the purposes described above.

The **business risks** supported by the **working capital** include, amongst others, any losses from **non-profit, unitised with-profits** and other business, the cost of death claims in excess of the charges made, the investment risk from **GARs** and other policy guarantees and the difference between expenses charged to policies and those actually incurred.

Certain compensation costs are met in the first instance from the **working capital** of the fund (see section B3). Should the **working capital** be unable to bear some or all of this cost, any shortfall will be met from the **asset shares** of with-profits policyholders.

The amount of **working capital** will fluctuate depending on a number of factors, such as the investment performance of the fund, the regulatory requirements in connection with determining the **solvency** position of the fund, and the extent to which the **working capital** is used in the ways described above. However, we regularly monitor whether the level of **working capital** remains sufficient.

We may hold back some profits if this is required to maintain a sufficient level of **working capital**. Conversely, if the level of **working capital** is more than we require to manage the business appropriately, we may share out additional profits to reduce the level of **working capital**. We would agree with our Board the time period over which such profits should be held back or additional profits distributed and the method by which any such profits are to be distributed.

The target level of working capital is determined as a multiple of the **Regulatory Capital Resource Requirements**.

Management actions

Management actions are actions that we may take in order that the fund can meet its **solvency** requirements and/or to ensure that the fund has an appropriate level of **working capital.**

Since all management actions that are taken have either a direct or indirect impact on with-profits policyholders, it is important that such actions are only taken if they are consistent with the principle of Treating Customers Fairly.

One or more of the following management actions might be taken to help meet the fund's **solvency** requirements or to ensure that the fund has an appropriate level of **working capital**:

- removal of past allocations of the Miscellaneous Surplus Amount, as set out in the table in section A5;
- reduction in the proportion of riskier assets such as shares and property held in respect of **traditional with-profits business** and **accumulating with-profits business** to 35% and 50% respectively;
- setting future rates of annual bonus to zero for **traditional with-profits business** and **accumulating with-profits business**; and
- increasing the charge made for guarantees for certain **traditional with-profits business** (as described in section A5) to 1% per annum, subject to the condition that the amount of charges levied does not exceed the amount of costs which they are intended to cover, over the expected lifetime of such policies.

If more stressed conditions arise in which there is a need to take further actions to help meet the fund's **solvency** requirements then one or both of the following actions may be taken:

- increasing the charge made for guarantees for certain **traditional with-profits business** (as described in section A5) to 1.25% per annum, subject to the condition that the amount of charges levied does not exceed the amount of costs which they are intended to cover, over the expected lifetime of such policies; and
- reduction in the proportion of riskier assets such as shares and property held in respect of **traditional with-profits business** to 25% except for those **traditional with-profits** policies which have a very high level of policy guarantees compared with the level of **asset shares** where the reduction would be to 0%. A reduction in the proportion of such riskier assets held in respect **accumulating with-profits business** to 35%.

If more severe stress conditions arise in which there is a need to take further actions to those described above to enable the fund to cover its **solvency** requirements, the most appropriate actions will depend on circumstances at the time. It follows that in principle further management actions beyond those described above are possible.

Actions which might be considered fall into two broad groups:

1. Actions to de-risk the fund and reduce exposure to future stresses – examples include reinsurance of longevity risk, closer matching of guaranteed liabilities by duration, reducing the proportion of riskier assets such as shares and property held in respect of policies as they approach maturity.
2. Actions to further increase charges to policyholders – examples include reducing target payouts to less than 100% of **asset shares** or further increasing guarantee charges.

Whenever these further actions need to be taken, the choice of such action(s) will depend on a number of factors including:

- Having regard to the aim of treating customers fairly.
- The cause of the change in fund strength and our view of its permanence.
- Availability of actions at the time as some may be particularly difficult to take given, for example, the market conditions at that time.
- Industry and regulatory conditions.
- Our view of future market conditions.
- The impact the action(s) will have on policyholders and among different groups of policyholders.

Section C

C1. Glossary

Accumulating with-profits policy: a with-profits policy for which the benefits are expressed in the form of an account derived by accumulating the premiums paid with bonus additions and deducting any expense charges or amounts that have been withdrawn. The **plan value** of an **accumulating with-profits policy** may, in certain circumstances, be reduced by an **MVR** and/or a cash-in charge.

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 with-profits fund in which the policy is invested and any distribution of working capital that has been allocated to the asset share. See section A5 for further details.

AVC: a **traditional with-profits** Additional Voluntary Contribution policy; a type of pension policy used to enhance pension benefits and which is taken out in conjunction with a company pension scheme.

Bonus series: a set of bonus rates that applies to a particular group of policies.

Business risks: risks undertaken within a long-term business fund and may include a number of exposures, for example:

- exposure to maintaining with-profits policies;
- exposure to maintaining **non-profit** and other policies;
- exposure to risks from other investments: for example, in subsidiary companies.

Compensation costs: payments made to policyholders as compensation or redress or ex-gratia payments, as required by regulation or legislation.

Derivatives: securities whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the value of the underlying assets.

Guaranteed annuity rate (GAR): the minimum rate of pension we guarantee to pay at the retirement date originally selected on the policy on certain pension policies, as described in the policy terms and conditions.

Guaranteed contractual amount: the minimum amount that we guarantee to pay (such as the sum assured plus any annual bonuses already declared) if a claim is made under the terms of the contract. Amounts payable on surrender, transfer or retirement at a date other than that specified in a contract are not guaranteed.

Guaranteed minimum pension: a minimum pension to be paid at state pension age that may apply to certain **Option 32 policies**.

Individual Capital Guidance: any additional reserve that our **Regulator** may require us to hold in respect of the fund's risks.

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.

Interest rate swap: an agreement between two parties to exchange different types of interest payments, typically exchanging variable rate payments for fixed rate payments.

ISA: an Individual Savings Account; a form of tax-free wrapper for a policy which means that all benefits are paid tax-free provided that account holders meet the Government's rules for ISAs. From 1 July 2014 all ISAs became New ISAs (NISAs) which allow increased contribution limits and flexibility for account holders.

Limit on expense deductions: the promise made to PP, FSAVC, APP and **Table P** policyholders that we will determine benefits in future so that the total expenses charged after 5 April 2001 is no greater than 1% each year of the policy value or such higher amount allowed under the legislation governing Stakeholder pensions.

Market value reduction (MVR): a reduction that may be made to the **plan value** of an **accumulating with-profits policy**, in certain circumstances (including, in exceptional circumstances, to protect the **solvency** position of the fund), when part or all of the plan is surrendered.

Matching: the investment of assets in such a way that the cashflows from the assets held in respect of a set of liabilities will be the same as the liability cashflows, irrespective of future economic conditions.

Non-profit business: insurance business that is written on fixed terms, so that policyholders do not share in any profits and losses arising from the business.

Option 32 policy: a **traditional with-profits** Section 32 pension buy-out policy.

Ordinary Branch business: business other than **Industrial Branch** business written in the fund.

Pension review guarantee: a guarantee offered to some pension policyholders as part of our pension review, set out in a Benefit Guarantee Certificate.

PHI: a permanent health insurance policy; a type of insurance policy that provides an income benefit in the event that the life assured suffers a disability or a long-term illness.

Plan value: the plan value of an **accumulating with-profits policy** is equal to the premiums paid, less any initial charge, plus any annual bonuses that have accrued, less any income or other withdrawals made by the policyholder.

Policy type: the form of with-profits policy held by the policyholder, e.g. endowment assurance, whole life assurance, personal pension.

Regulator: The Financial Conduct Authority or the Prudential Regulation Authority, as appropriate. The Royal London Mutual Insurance Society Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

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

Royal London Actuary: the person appointed by us to perform the "actuarial function", as described in the Prudential Regulation Authority's Handbook (SUP 4.3.13R).

Smoothed asset share: the **asset share** calculated using investment returns that are averaged over a number of years.

Solvency/Solvent: the regulatory requirement that we have sufficient assets to meet future liabilities and to provide a margin for risk. Included within this requirement are amounts of additional capital the **Regulator** may require us to hold when providing **Individual Capital Guidance**.

Special condition: the condition applied to RLCIS OB & IB Fund regular premium personal pension contracts taken out after 1 April 1999 that, should a policyholder decide to transfer the value of a contract into a stakeholder pension, the amount payable on transfer would not be less than the total premiums paid to the date of transfer (excluding any premiums paid in respect of life assurance or waiver of premium cover). A similar guarantee applies in respect of increases to existing personal pension and other annuity and pension policies.

Swaptions: an option to enter into an **interest rate swap** at some fixed point in the future, at a pre-determined fixed interest rate.

Table P policy: a **traditional with-profits** Section 226 deferred annuity policy.

Traditional with-profits policy: a with-profits policy where the benefits paid on death or on a maturity or specified retirement date are expressed in terms of a guaranteed benefit to which bonuses may be added.

Transfer Scheme: the insurance business transfer scheme approved by the High Court on 9 December 2014 for the transfer of the long term business of Royal London (CIS) Limited to Royal London with an effective date of 30 December 2014.

Unitised with-profits policy: a policy for which benefits are expressed in terms of units, whose price varies over time.

Unsmoothed asset share: the **asset share** calculated using actual investment returns obtained in each calendar year.

With-Profits Actuary ("WPA"): the person appointed by us to perform the "with-profits actuarial function", as described in the Prudential Regulation Authority's Handbook (SUP 4.3.16R).

With-Profits Committee ("WPC"): the with-profits committee appointed by us in accordance with the Financial Conduct Authority's Handbook (COBS 20.5).

Working capital: the excess of assets maintained in the Royal London (CIS) Sub-Fund over the amount needed to meet its liabilities in accordance with the **Regulator**'s rules for assessing the value of the fund's liabilities and before any allowance for any future distributions of the working capital of the Royal London (CIS) Sub-Fund. These liabilities include those which arise from the regulatory duty to treat customers fairly when setting discretionary benefits.

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