PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT (PPFM)

Royal Liver Sub - Fund

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Principles and Practices of Financial Management
Royal Liver Sub-Fund

CONTENTS

Introduction

The business of Royal Liver Assurance Limited (*Royal Liver*) was transferred to The Royal London Mutual Insurance Society Limited (*Royal London*) with effect from 1 July 2011. The legal terms of the transfer were set out in an Instrument of Transfer (the *Royal Liver Instrument of Transfer*) confirmed by the Financial Services Authority. The policies, and certain assets and liabilities of *Royal Liver*, were allocated to a separate sub-fund (the *Royal Liver Sub-Fund*) of the Royal London Long Term Fund (*RL LTF*) created for that purpose.

The *RL LTF* now consists of the *RL Main Fund*, the *SL Closed Fund*, the *PLAL With-Profits Sub-fund* and the *Royal Liver Sub-Fund* and the Royal London (CIS) Sub-Fund.

The operation of the *RL Main Fund*, the *SL Closed Fund*, the *PLAL With-Profits Sub-fund* and *RL (CIS) Sub-Fund* are described in separate documents.

This document sets out the Principles and Practices of Financial Management by which *Royal London* will manage the *Royal Liver Sub-Fund* (the *fund*). The aim of this document is to explain and promote understanding of how the *fund* is managed and of the potential risks and rewards from holding a *with-profits policy* in the *fund* with *Royal London*. It covers those issues which *Royal London* reasonably foresees may have a significant impact on the management of the *fund*. These issues include for example the mutual status of *Royal London*, the management of the *inherited estate* of the *fund*, the exposure to various types of business risk, the investment strategy of the *fund*, the amount payable from a *with-profits policy* and the *fair* treatment of *with-profits policyholders*.

Royal Liver was an incorporated friendly society with no shareholders and a single with-profits fund in which both with-profits and non profit business, including unit-linked business, were written. Industrial Branch and Ordinary Branch business had been written in that with-profits fund in both the United Kingdom and the Republic of Ireland.

The *fund* is closed to new business, other than that arising on the exercise of options attaching to existing policies to effect premium increments, additional benefit coverage or additional policies.

Some with-profits and non profit business in the *fund* was previously transferred by means of schemes of transfer to *Royal Liver* from Caledonian Insurance Company Limited at 31 December 2000, from Friends' Provident Life Office at 31 March 2001, from Civil Servants' Annuities Assurance Society (CSAAS) at 19 December 2001[1] and from Irish Life Assurance plc at 28 February 2002 (the *Predecessor Schemes*). These blocks of transferred business all form part of the *fund* and the management of this business is also subject to the legal terms of the relevant transfer: as a result this document sometimes refers to these blocks of business separately. *Royal Liver* also traded under the name Caledonian Life in the Republic of Ireland, but business written under this name after 1 January 2001 and before 1 July 2011 is covered by the relevant Royal Liver section in this document.

This Introduction does not form part of either the Principles or the Practices, and is included solely to aid understanding of the Principles and the Practices. Defined terms are shown in *italics* and are explained in the Glossary.

[1] All with-profits policies of CSAAS were provided with fixed guaranteed increases in benefits and ceased to participate in profits from 19 December 2001. CSAAS policies for which regular premiums were being made were converted to paid up for the full benefits at the date of transfer. CSAAS policies are not considered further in this document.

The Principles are high level statements of the standards *Royal London* will follow in the management of the *fund*. These set out how *Royal London* intends to manage the *fund* over the *longer term* and how *Royal London* expects to respond to *longer term* changes in the business, regulatory or economic environment. The Principles are not expected to change often although it is possible for them to be changed in the future.

The Practices describe *Royal London*'s approach to managing the *fund* and to responding to shorter term changes in the business, regulatory or economic environment. In other words the Practices describe how *Royal London* intends to follow the Principles in the day-to-day management of the *fund*. Hence as circumstances change the detail of the Practices will evolve, whilst always conforming to the Principles.

Royal London reviews its compliance with this document annually and the outcome of that review will be described in an annual report to *with-profits policyholders,* which will be made available on the *Royal London* website.

The *Directors* have established a With Profit Committee to provide advice on the way the *fund* is managed, to provide an independent view when they are considering the interests of *with-profits policyholders* and to monitor compliance with the PPFM.

Any changes to the Principles will usually be advised to *with-profits policyholders* in writing at least three months before the changes become effective unless otherwise agreed with the *Regulator*. The advance notice may be contained in annual statements we send to policyholders.

Any changes to the Practices will be notified to *with-profits policyholders*. Depending on the timing of the change in Practices, the notification of the change may be after it has taken effect, but will always be within a reasonable time period from the effective date of the change. We will seek to minimise the costs of notification by combining it with other communications to policyholders of the *fund*.

Principles

This section sets out the Principles that apply to the *fund*.

Royal London applies some overall guiding principles when managing the *fund* under the Principles and Practices set out in this document. Where there is conflict between one or more Principles or Practices or between any of these and the overall guiding principles the *fund* will be managed so that the guiding principles are applied.

1.0 Guiding Principles

Royal London will manage the *fund* in accordance with the legal and regulatory requirements that apply to it from time to time.

Royal London will manage the *fund* in compliance with the provisions of the *Royal Liver Instrument of Transfer*[2]. If a conflict with a Principle or Practice in this document arises then the provisions of the *Royal Liver Instrument of Transfer* will take precedence.

Royal London will conduct its business in a sound and prudent manner with due regard to the interests of its policyholders and with a view to treating policyholders *fairly*.

Royal London will aim to manage the *fund* in order to ensure that all *guaranteed benefits* can be paid as they fall due. This will include observing all contractual terms set out in policy terms and conditions.

Royal London will manage the *fund* as if it comprised a stand-alone mutual UK life insurance company having the assets and liabilities of the *fund* (excluding any assets or liabilities arising in respect of capital support provided to the *fund*), disregarding the future availability of any capital support and subject to the *Regulatory Capital Resource Requirements* that would apply to such a stand-alone company.

1.1 Amount payable under a with-profits policy

1.1.1 Aims of methods used

The aims of the financial management of the *fund* are to ensure that:

- the *fund* is able to satisfy its ongoing *Regulatory Capital Resource Requirements*;

and, subject to that aim, that:

- on average over the *longer term* the amount paid on death, *maturity* and surrender is 100% of the *asset share*, subject to a minimum of the *guaranteed benefits* or any guaranteed surrender benefits.

Royal London will aim to meet the reasonable expectations of all policyholders of the *fund*, treating different classes and generations of policyholders *fairly*.

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[2] These require that the principles of financial management contained in the *Predecessor Schemes* continue to apply to the relevant policies of the *Royal Liver Sub-Fund*, and take precedence over other principles in the *Royal Liver Instrument of Transfer* as long as they are applicable.

One aspect of *fairness* is the need to ensure that the interests of remaining policyholders are safeguarded against the impact of policyholders voluntarily exiting the *fund*. *Royal London* aims to meet the reasonable expectations of these policyholders but, where it considers it appropriate to do so, it will make deductions from the amounts which would otherwise be paid on surrender or transfer in order to safeguard the benefits of continuing policyholders. Any such deductions will accrue to the *inherited estate* of the *fund*.

1.1.2 Degree of approximation allowed

For deaths and maturities, since the average percentage of *asset shares* is taken over all policies becoming claims over a number of years, the amount paid out on any individual claim or on claims in any one year may be more or less than the above target percentage of *asset shares*, and will not closely follow day to day fluctuations in *asset share* caused by normal market volatility.

For classes of policy where *asset shares* are not calculated the payout may be determined by methods which provide an approximation to *asset share*.

1.1.3 Controls over change of methods

Changes to the methods used to determine payouts will be approved by the *Directors*, after receiving advice from the *With-Profits Actuary*. No changes will be made that are inconsistent with the *Royal Liver Instrument of Transfer* without agreement from the *RLSF Supervisory Committee*.

1.1.4 Circumstances under which historical assumptions might change

The *asset shares* immediately after the transfer of the business to *Royal London* will be unchanged in any material respect from the *asset shares* immediately before the transfer except to the extent that any manifest errors or omissions need to be corrected.

Assumptions or parameters used in the calculation of *asset shares* after the transfer date in respect of the period after the transfer date, once made, will only be subject to change thereafter to the extent that they are found to be incorrect, to reflect new information or to maintain fairness between policyholders. The *Directors* may decide not to make such changes if the impact on *asset shares* would not be *material* for a *significant* class of policyholders.

1.2 Annual bonus policy

The aims in setting *annual bonus rates* at a particular point in time are that they can be maintained over the *long term* based on *prudent* current expectations of future investment returns and other experience and that they should be set at levels that do not unduly constrain investment freedom or the prospects for declaration of *final bonuses*.

Annual bonuses will be set at rates which are affordable and which will not prejudice the future distribution of the *inherited estate fairly* amongst different policyholders. *Annual bonus rates* may be reduced below the *long term supportable* level during adverse economic circumstances. There are no constraints on the level of *annual bonus rates* either in the form of a positive minimum level (they may be nil) or a maximum change from one declaration to the next.

1.3 Final bonus policy

Final bonus rates are set having regard to the principles for determining payouts and for *smoothing* described in sections 1.1 and 1.4. Other than for classes of business for which *asset shares* are not used as a guide for determining payouts, final bonus rates are set with the intention that on average over the *longer term* the amount paid on death or *maturity* is 100% of the *asset share*, subject to a minimum of the *guaranteed benefits*.

Final bonus rates may be reduced rapidly during adverse changes in economic or other circumstances which lead to a deterioration in the financial strength of the *fund*. There are no constraints on the level of final bonus rates either in the form of a positive minimum level (they may be nil) or a maximum change from one declaration to the next.

1.4 Smoothing policy

Payouts on *with-profits policies* will be smoothed having regard to the practice of *Royal Liver* immediately before the transfer of business to *Royal London* but *smoothing* will always be carried out in a way that does not unreasonably jeopardise the ability of the *fund* to meet its *Regulatory Capital Resource Requirements*.

Smoothing is not intended to be neutral over a particular time period for any type of claim. On average over the *longer term* the amount paid on death, *maturity* and surrender is targeted to be 100% of the *asset share*, subject to a minimum of the *guaranteed benefits* and the necessity of the *fund* meeting its *Regulatory Capital Resource Requirements*.

The approach to *smoothing* depends upon the type of claim arising and the nature of the business. For former policies of Irish Life, Caledonian Insurance and Friends' Provident, the *smoothing* approach is constrained by requirements specified in the relevant Principles of Financial Management document.

For *conventional with-profits policies*, surrender values for most classes of policy are closely based on *asset shares* and the degree of *smoothing* is slight. For maturity and death payouts, *smoothing* arises through the application of uniform bonus scales within policy groups. Therefore, *smoothing* arises within policy groups.

For *unitised with-profits policies* payouts closely follow *asset share* and the degree of *smoothing* is slight.

Market Value Reductions may be applied to *unitised with-profits policies* to reduce the level of *smoothing* applied to voluntary exits and reduce payouts to bring them closer to *asset shares*.

1.5 Investment strategy

The aim of the investment strategy of the *fund* is to maximise as far as is reasonably practicable the returns to with-profits investors, while preserving the ability of the *fund* to meet its guaranteed liabilities and commitments and maintaining the *inherited estate* at an appropriate size.

The non profit business in the *fund* is backed either by cash and fixed interest holdings of an appropriate term or (in the case of unit linked business) by appropriate matching linked assets.

In determining the mix of assets between different asset classes in respect of the remainder of the *fund*, the investment strategy will take account of the nature of the liabilities of the *fund* (including the currency in which they are denominated), the financial strength of the *fund*, its ability to meet its *Regulatory Capital Resource Requirements*, the *long term* expected returns available in each asset category and their volatility, and the benefits to be obtained from diversification. A portion is invested in equities and property where circumstances allow this. The proportions held in fixed interest and cash will be varied to maintain adequate protection for the *inherited estate*.

In determining the investment strategy of the *fund*, no reliance is placed on the potential or actual provision of capital support from outside the *fund*.

In considering the range of assets in which to invest, the *fund* may use derivatives and other financial instruments for efficient portfolio management or for the purpose of hedging its risks and to protect the financial strength of the *fund*. In order to reduce the risk of loss resulting from failure of a third party the *Directors* set limits for exposure to various counterparties, taking into account their credit rating and any other contracts *Royal London* has with them.

Different investment strategies may be used for the *inherited estate* and other parts of the *fund*. There are no constraints on varying the investment strategy between different classes or generations of *with-profits policyholders*.

The *fund* may also hold assets that are not normally traded, to support the operation of the business. These include physical assets such as office buildings.

Any such holdings are reviewed to ensure that they continue to form an appropriate proportion of the *fund*.

The change in value of these assets forms part of the overall investment return which influences the amounts payable under *with-profits policies*.

1.6 Business risk

The business risks within the *fund* will be limited to those provided for in the *Royal Liver Instrument of Transfer*.

The benefits and costs from a business risk form part of the *miscellaneous profits or losses* and are allocated in the first instance to the *inherited estate*. These will affect *asset shares* through the way that the *inherited estate* is managed according to the principles set out in section 1.8.

1.7 Charges and Expenses

Policy administration, investment management and other aspects of the management of the *fund* are provided to the *fund* by *Royal London* in return for fees determined in accordance with the *Royal Liver Instrument of Transfer*. Except as provided for in the *Royal Liver Instrument of Transfer*, costs arising from operational issues occurring after the date of the transfer will not be charged to the *fund*.

In allocating the charges and expenses between policy types the aim is to ensure that each policy is charged, implicitly or explicitly, an amount which represents a *fair* proportion of the total charges and expenses incurred, using accepted actuarial techniques.

The *Directors* reserve the right to allocate some expenses and costs to the *inherited estate* provided that doing so does not lead to a distortion of *smoothing* policy or *materially* restrict investment freedom.

The factors which would drive any change to the basis on which expense charges are apportioned or discretion is exercised to apply charges to particular *with-profits policies* include, but are not limited to, the following:

- the size of *inherited estate*;
- the accuracy of the apportionment of expenses and costs;

1.8 Management of the inherited estate

The *inherited estate* is managed with the aim of ensuring that it enables the *fund* to at least meet the following primary purposes:

- to enable *smoothing* of payouts on *with-profits policies*;
- to allow the desired degree of investment freedom;
- to provide the capital to cover its *Regulatory Capital Resource Requirements*.

The *Directors* will seek to maintain an *inherited estate* of a size that they consider appropriate to meet its stated purposes, taking into account actuarial advice.

The *fund* will be managed in accordance with the terms of the *Royal Liver Instrument of Transfer*, which sets out the division of the *fund* from the other assets within the *RL LTF* and the principles underlying the distribution of the *inherited estate*. The *inherited estate* will be distributed over the remaining lifetime of the existing policies of the *fund* to eligible policies in the form of enhanced payouts in a manner which the *Directors* consider to be as *fair* and equitable as practicable.

If the size of the *inherited estate* is above the *Upper Capital Threshold* then the excess will be eliminated by making enhancements to *asset shares* of *with-profits policies* and allocating contingent bonuses to *contingent reversionary bonus policies*. In the first instance the enhancements will be applied to restore the *asset shares* of *LM policies* so as to reduce or remove any previous shortfall deductions from those *asset shares* (see below). Any excess remaining after restoration of the *asset shares* of *LM policies* will be used to enhance the *asset shares* of the remaining *with-profits policies* and allocate contingent bonuses to *contingent reversionary bonus policies*.

If the size of the *inherited estate* falls below the *Lower Capital Threshold* then any enhancements previously made to *asset shares* of *with-profits policies* and contingent bonuses allocated to *contingent reversionary bonus policies* will be removed to the extent necessary to eliminate the shortfall.

If the size of the *inherited estate* falls below the *Minimum Capital Threshold* then deductions will be made from *asset shares* of *with-profits policies* to the extent necessary to eliminate the shortfall. These deductions will in the first instance be made from *asset shares* of *with-profits policies* that are not *LM policies*. If this action is insufficient to eliminate the shortfall, deductions will then be made from *asset shares* of *LM policies*.

If, in extreme circumstances, the *fund* requires capital support from outside the *fund* in order to meet its *Regulatory Capital Resource Requirements* then assets of the *RL Main Fund* will be earmarked to cover the shortfall providing the *RL Main Fund* has the necessary financial resources to do so.

If, in extreme circumstances, the *RL Main Fund* requires capital support in order to cover its liabilities then, at the discretion of the *Directors*, assets of the *fund* may be earmarked to cover the shortfall for so long as the *fund* has the necessary financial resources to do so.

In such circumstances the fund receiving the capital support will be managed so that the requirement for support can be removed at the earliest possible time. The charge to be incurred by the fund receiving the capital support if such support is provided will be determined in accordance with the terms specified in the *Royal Liver Instrument of Transfer*.

1.9 Volumes of new business

The *fund* is closed to new business, other than that arising on the exercise of rights or options attaching to existing policies as allowed for by the *Royal Liver Instrument of Transfer*.

1.10 Ceasing to maintain the fund

When the total *asset shares* of *with-profits policies* in the *fund* fall below £250 million (adjusted annually on 31 December each year in line with changes in the UK Retail Prices Index), *Royal London* may cease to maintain the *fund* as a separate sub-fund of the *RL LTF*.

When those *asset shares* fall below 40% of that annually adjusted figure then the *fund* will cease to be separately maintained.

At the point of cessation, the assets and liabilities of the *fund* and the policies allocated to the *fund* will be allocated to the *RL Main Fund*. Any excess of the realistic value of assets within the *fund* over the realistic value of liabilities at the date of cessation will be allocated as enhancements to the *asset shares* of the *with-profits policies,* and as contingent bonuses on the *contingent reversionary bonus policies,* that were invested in the *fund* and which remain in force at the time of the allocations. The manner and timing of such allocations will be such that the *Directors* believe they are *fair* having regard to the reasonable expectations of the policyholders and the advice of the *With-Profits Actuary* of *Royal London*.

To the extent that any *inherited estate* of the *fund* has not been allocated to such policies after the date of cessation of the *fund*, it will be adjusted to reflect investment return earned after cessation and to reflect any other experience arising after cessation that relates to *with-profits policies* that were in the *fund* immediately before the date of cessation.

If at the date of cessation, the *fund* is in receipt of capital support, then repayment of that support to *Royal London* shall take priority over any enhancements.

Following the cessation of the *fund*, the *RLSF Supervisory Committee* will cease to exist.

Practices

2.1 Amount payable under a with-profits policy

2.1.1 General Practices

This section sets out the general practices that apply to blocks of business. These may differ for specific types of policy or in certain circumstances, such as where the policy has been made paid-up or otherwise altered. Where there is any apparent conflict, the statements within policy documents will, in general, take precedence over any statements issued in this document. The exception to this is where practices in relation to surrender values override policy conditions, to the benefit of the policyholder.

Generally, *asset shares* are used as a guide when setting payouts under *with-profits policies* (other than *contingent reversionary bonus policies*). However, the payout will be subject to a minimum of any amount guaranteed to be paid under the terms of the policy.

The amounts payable and the manner in which they are paid will depend on the type of policy.

Conventional with-profits policies (other than contingent reversionary bonus policies)

The amount paid on maturity claims for *conventional with-profits policies*, and on death claims for *conventional with-profits life policies*, is currently the sum of:

- the *guaranteed basic sum assured on maturity* or the *guaranteed basic sum assured on death*, as appropriate;
- the attaching annual *bonuses* previously declared;
- an *interim bonus*;
- a final *bonus*.

For death claims the amount paid is subject to a minimum of any *guaranteed minimum death benefit* and is always subject to a maximum of any *maximum death benefit*.

The amount paid on death claims for *conventional with-profits pension policies* is determined by the terms of the policy and is not generally set by reference to *asset shares*.

Payments will be adjusted for any debt, adjustments and loans accrued to the policy.

The *interim bonus* and final *bonus* are not guaranteed and may be withdrawn at any time.
The amount paid on surrender claims for *conventional with-profits policies* is currently determined by formulae which vary for different types of policy, but are generally based on *asset shares*.

Unitised with-profits policies (including converted with-profits pension policies)

The amount paid on maturity claims and on death claims for *unitised with-profits policies* is

- the *face value of units*; plus
- any *final bonus*

The amount paid on surrender claims for *unitised with-profits policies* is

- the *face value of units*; plus

- any *final bonus*; minus
- any *surrender penalty*; minus
- any *Market Value Reduction*

unless the surrender is at a *no MVR date*, in which case no *Market Value Reduction* would be deducted.

The *final bonus* is not guaranteed and may be withdrawn at any time. The size of the *Market Value Reduction* may be varied at any time.

Contingent reversionary bonus policies

The amounts paid on *contingent reversionary bonus policies* are not set by reference to *asset shares*. They are currently the sum of:

- the guaranteed sum assured;
- any final *bonus;*
- less any debt, adjustments and loans accrued

The final *bonus* is not guaranteed and may be withdrawn at any time.

The *Directors* will only apply a *final bonus* to these policies when discretionary allocations from the *inherited estate* have been made to the *asset shares* of *conventional with-profits policies* and *unitised with-profits policies* and those allocations have not been removed (see section 2.8).

The amount paid on surrender claims for *contingent reversionary bonus policies* is currently determined by a formula that takes account of the benefits that would be payable if the policy had not been surrendered and premiums that will not be paid.

The remainder of this section 2.1 does not apply to *contingent reversionary bonus policies*.

2.1.2 Target ranges for maturity and surrender payouts

We aim to set bonus rates so that at least 90% of maturity payouts are expected to fall between 80% and 120% of *asset share*.

We also aim to set surrender value bases so that at least 90% of surrender payouts are expected to fall within 80% and 120% of *asset share*.

In each case, payouts are compared to *asset shares* adjusted for any debt, adjustments and loans accrued to the policy.

We will review these ranges periodically, usually annually.

There may be circumstances where maturity values and surrender values will not fall into these target ranges. For example:

- *guaranteed benefits* may be greater than *asset shares*;
- the non guaranteed element of surrender and maturity payouts may be reduced in order to protect the *solvency* position of the *fund*;
- there may be extreme investment conditions; and/or
- surrender values may be subject to the legal terms of a previous transfer to *Royal Liver*.

Final bonus rates (see section 2.3) are set initially to ensure that an overwhelming majority of payouts are expected to fall within the ranges above. Throughout the year, actual payouts will be monitored against *asset shares*. Final bonus rates and/or surrender value calculation routines may be altered if an excessive proportion of payouts fail to lie within, or are expected to fail to lie within, the ranges set out above.

Not all with-profits maturity values and surrender values will be measured against the ranges above. Exceptions include products for which the use of *asset shares* would not give a *fair* payout.

Where an *asset share* is not calculated, or where *asset shares* do not represent a *fair* guide to payouts, with-profits payouts are determined using other methods. These methods aim to arrive at amounts consistent with those calculated for other *with-profits policies* in order to ensure *fairness* between the different policy types.

There may be circumstances where the ranges above are no longer appropriate and need to be altered by widening or narrowing the ranges. There may be different ranges for different types of business. However, ranges would normally be expected to change only on a very infrequent basis.

Any changes to the ranges set out above will be approved by the *Directors* after receiving advice from the *With-Profits Actuary*.

We may target payouts at above 100% of *asset shares* in order to distribute the *inherited estate fairly* over the lifetime of the policies entitled to receive a share.

We may target payouts at less than 100% of *asset share* with the aim of recouping smoothing costs and/or to protect the *solvency* of the *fund*

2.1.3 Asset share methodology

This section summarises the current methodology. Calculations may have been done differently or more approximately in the past. Past methodology may have been different, for example because of requirements arising under the *Predecessor Schemes*.

This section summarises the methodology that is generally applied and then, in sections 2.1.3.1 to 2.1.3.3, summarises the differences that currently apply in respect of policies previously transferred to *Royal Liver* under the *Predecessor Schemes*.

Generally, *asset shares* are calculated on a retrospective basis for sample model points which we consider provide a fair representation of the relevant *with-profits policies*. *Sample model point asset shares* are typically determined by averaging *asset shares* across policies grouped together by bonus series, duration (or, for whole of life policies, year of entry and age at entry) and policy conditions.

Asset shares are calculated by accumulating premiums paid at the rate of return earned on the assets backing the policies after allowing for charges. These charges include the expenses incurred (for example set up costs, administrative fees and investment management costs), the cost of risk benefits, the cost of guarantees, the cost of *smoothing* and the cost of tax. *Asset shares* also allow for any addition or removal of discretionary allocations in respect of *miscellaneous profits or losses* or the *inherited estate*.

If the policy allows investment in both with-profits and unit-linked funds the *asset share* is calculated only in respect of the with-profits part of the policy.

Approximate methods are used in practice where the retrospective *asset share* is not considered relevant.

The Chief Actuary documents the methods, parameters and assumptions that are made when calculating *asset shares*, how these have been derived and any changes made, and the systems used to deliver these methods.

If we wish to make any *material* changes to the methods, assumptions and parameters used in determining *asset shares* or bonus rates, the Chief Actuary will document the changes and present them to the *Directors* for approval together with an analysis of their effect on *with-profits policyholders*. The *Directors*, having received advice from the *With-Profits Actuary*, will consider the information set out before them in light of the effects the changes will have on the benefits for *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 *Directors* may at their discretion delegate this responsibility.

Conversely, if the proposed changes would be inconsistent with the *Royal Liver Instrument of Transfer* the agreement of the *Royal Liver Supervisory Committee* would be required before the changes were implemented.

The primary methods we use to calculate *asset shares* are described below.

The *asset share* is built up iteratively from the start of the policy as follows:

- *asset share* at start of period;
- plus premiums received in period, including any associated tax relief;
- minus an adjustment for any partial withdrawals;
- plus investment return earned in period;
- minus the cost of or charges for life cover or other risk benefits;
- minus expenses or charges for expenses;
- plus allowance for tax relief (where applicable);
- minus allowance for tax (where applicable);
- minus any charges to help meet the cost of providing guarantees;
- plus any discretionary allocation of *miscellaneous profits or losses*;
- plus any discretionary allocation from the *inherited estate* or minus any past discretionary allocations from the *inherited estate*.

The premium is the actual premium receivable in the period.

The investment return is the actual return earned on the assets (net of investment management expenses) deemed to back the relevant with-profits business. Where calculations need to be performed for periods where the actual return is not yet known, estimates of the investment return will be used. These estimates are replaced by actual returns once they become available for use in subsequent *asset share* calculations.

The assets backing the relevant with-profits business may vary according to the type of business, the level of *guaranteed benefits* relative to the *asset shares* and the term since the start of the policy or the remaining term to the maturity date.

The cost of life cover is the mortality rate for the age, sex and type of business multiplied by the excess of the death benefit over the *asset share*. The *asset share* used for this purpose is reduced by the amount of any cash benefits paid out.

The mortality rate assumed is currently derived from an internal investigation of actual experience. Where insufficient experience is available for a credible internal investigation industry experience expressed in terms of published mortality tables is used.
The per policy expenses and the expenses expressed as a percentage of the *asset shares* that are charged to the *asset shares* of *conventional with-profits policies* are based upon the corresponding charges that are charged to the *fund* in accordance with the *Royal Liver Instrument of Transfer*.

The charges made to cover initial and maintenance expenses in respect of Royal Liver *unitised with-profits policies* are those specified in the relevant contract.

The amounts in respect of tax relief on expenses and the tax incurred on the investment return reflect the rates of tax applicable in each year and the tax position of the *fund*. Under the terms of the *Royal Liver Instrument of Transfer* the amount representing tax charged to the *fund* is calculated as if the *fund* were a stand-alone mutual insurance company.

Royal London is a mutual company, and so there are no transfers to shareholders from the *fund* and no need to consider the tax consequences of shareholder transfers.

Guarantee costs may be incurred in the following circumstances:

(i) the guaranteed maturity benefits exceed the *asset share* for maturing policies;
(ii) the guaranteed surrender value exceeds the *asset share* for surrendering policies;
(iii) the value of a guaranteed annuity option exceeds the guaranteed maturity benefits for a maturing policy;
(iv) the value of a guaranteed cash option exceeds the guaranteed maturity benefits for a maturing policy.

An annual charge may be made to enable the *fund* to meet some or all of the cost of providing guarantees. This charge may be applied by reducing the investment return credited to *asset shares* by an amount per annum or by reducing the *asset share* directly.

Details of the charges currently levied on the *asset shares* for the cost to the *fund* of providing guarantees are published on the Royal London web site.

The following may form part of the *miscellaneous profits or losses* allocated to *asset shares* at the discretion of the *Directors:*

- any difference between the actual guarantee costs and guarantee charges levied on *asset shares*;
- any difference between the actual tax charged to the *fund* and the tax reflected in *asset shares*;
- profits and losses arising on non profit business written in the *fund*; and
- profits and losses from other business risks of the *fund*

The *Directors* currently take into account the following factors when exercising their discretion in the allocation of *miscellaneous profits or losses* to *asset shares*:

- ensuring that the *fund* covers its *Regulatory Capital Resource Requirements*;
- the desire to maintain the *inherited estate* at broadly the level needed to achieve the aims set out in section 1.8 above;
- the desire to allocate *miscellaneous profits or losses* to those types and generations of policies that generated them, as far as it is reasonably practical to be able to identify this.

Any discretionary allocation of *miscellaneous profits or losses* to *asset shares* will be expressed as a percentage of *asset shares* in that year.

The amount of *miscellaneous profits or losses* taken into account when calculating *asset shares* and the amount of any discretionary allocation of the *inherited estate* or any removal of previous allocations, and the circumstances in which an allocation or a reversal of an allocation might take place are described in section 2.8 below.

To the extent that gross of tax investment returns and any *miscellaneous profits or losses* taken into account are calculated in aggregate there is significant pooling of experience across generations of *with-profits policyholders* and across different types and classes of *with-profits policies*. The use of *sample model point asset shares* (generated by averaging *asset shares* calculated for individual policies), rather than the *asset shares* of individual policies, and the use of final bonus rates for a given period based on *asset shares* calculated as at the beginning of the period, also introduce approximations into the application of the *asset share* methodology.

2.1.3.1 **Irish Life** (Industrial Branch conventional with-profits business)

For business transferred from Irish Life to *Royal Liver* at the effective date of 28 February 2002 the *asset share* is calculated by taking the adjusted *asset share* at that date (determined in accordance with the relevant scheme of transfer) and following the method described above. However, the following features and differences apply:

- the investment return is at the rate credited for other industrial branch *with-profit policies* written by *Royal Liver* in Ireland with due allowance given to holdings of *Prize Bonds*;
- mortality costs are based on mortality rates of 60% (50% from 2007) of the ILT10 table for policies written under the 1980 Prospectus and of 80% (56% from 2007) of the ILT10 table for policies written under previous Prospectuses;
- the expenses are derived from internal expense investigations but up to 31 December 2011 they are restricted to a maximum level determined by the relevant scheme of transfer;
- tax is allowed for at the same rate as for other industrial branch business written by *Royal Liver* in Ireland;
- allocation of *miscellaneous profits or losses* is at the same rate as allocated to the *asset shares* of industrial branch business written by *Royal Liver* in Ireland minus a deduction of 1% per annum, subject to a minimum of zero.

The *With-Profits Actuary* will approve any changes to the rates of mortality cost deductions.

2.1.3.2 **Caledonian Insurance** (Ordinary Branch conventional with-profits business)

For business transferred from Caledonian Insurance to *Royal Liver* at the effective date of 31 December 2000 the *asset share* is calculated by taking the adjusted *asset share* at that date (determined in accordance with the relevant scheme of transfer) and following the method described above. However, the following features and differences apply:

- the investment return is at the rate credited for other ordinary branch *with-profit policies* written by *Royal Liver* in Ireland;
- a mortality charge is not applied;
- until 31 December 2010 the expenses charged to *asset shares* were consistent with the corresponding deductions made in 1999 but monetary amounts are inflated from 31 December 1999 at the rate of price inflation in Ireland plus 1% per annum;

- tax is allowed for at the same rate as for other ordinary branch business written by *Royal Liver* in Ireland;
- the allocation of *miscellaneous profits or losses* is at the same rate as allocated to the *asset shares* of ordinary branch business written by *Royal Liver* in Ireland. (An additional 1.25% per annum applied in accordance with the relevant scheme of transfer until 31 December 2010. The addition has not been applied since that date.)

2.1.3.3 **Friends' Provident** (Industrial Branch conventional with-profits business)

For business transferred from Friends' Provident Life Office to *Royal Liver* at the effective date of 31 March 2001 that was originally transferred to Friends' Provident Life Office from Friends' Provident (London & Manchester) Assurance Limited on 4 January 2000 (*LM policies*) the *asset share* is calculated by taking the *asset share* at 31 March 2001 determined in accordance with the Schedule 2C scheme under which this business was transferred on 4 January 2000 and following the method described above. However, until 31 December 2009 the following features and differences applied:

- the amount of premium taken into account was the part of the premium which, accumulated at 4.75% per annum interest from policy inception to *maturity*, equals the sum assured plus a simple bonus of 2.25% per annum;
- the investment return was added at the rate credited for other industrial branch *with-profit policies* written by *Royal Liver* plus 1.2% per annum ;
- the investment expenses, net of tax relief, were consistent with the Investment Expense Agreement of Friends' Provident that applied before 31 March 2001;

From 1 January 2010:

- The full premium paid is added to the *asset share*, rather than the proportion reflected prior to that date;
- The administration and investment management expense deductions is derived from internal expense investigations;
- the additional 1.2% per annum no longer applies;
- A charge in respect of mortality risk is applied; and
- The amount of any cash bonuses paid is deducted (with appropriate transitional arrangements in respect of the proportion of any cash bonuses accruing prior to 1 January 2010).

Other than in the circumstances described in section 2.8, *LM policies* will not be entitled to participate in any discretionary allocations from the *inherited estate*.

For Friends' Provident business written after 3 January 2000 and transferred to *Royal Liver* with effect from 31 March 2001, *asset shares* are calculated using a method consistent with that used for Royal Liver conventional with-profits industrial branch business.

2.2 Annual bonus methodology

The current approach to setting *annual bonus rates* is as follows:

Current *asset shares* are projected forward to the end of the policy term for policies with a maturity date based on *prudent* assumptions for future experience, in particular investment returns, mortality, expenses and expense charges, guarantee charges, tax and any *miscellaneous profits or losses* taken in to account for representative sample policies as described in section 2.1.3 above. *Guaranteed benefits* are projected forward assuming different levels of *annual bonus* in the future, starting with current *annual bonus rates*. The projected *asset shares* and *guaranteed benefits* are compared to assess whether *asset shares* are expected to exceed *guaranteed benefits* by sufficient margin to leave a reasonable level of *final bonus*. The size of this margin varies by the type of policy and by duration in force.

The choice of actual *annual bonus rate* from the range of *supportable* rates is based on consideration of factors which include, but are not limited, to the following:

- the current *annual bonus rate* and the desire to make gradual changes where possible;
- the current level of and recent changes in yields on government bonds of relevant duration in the U.K. and Ireland;
- past practice in relation to applying uniform bonus rates across U.K. and Irish policies of the same type, as well as policies with different tax treatments. For example taxable and tax exempt business of the same type written on the same premium rates currently have the same bonus rate;
- the ability of the *fund* to meet its *Regulatory Capital Resource Requirements*.

Annual bonus rates are subject to review at least once a year.

Annual bonus rates cannot be negative but the actual rate chosen can be zero and there is no maximum amount by which *annual bonus rates* may be changed at any review.

The approach to setting rates of *interim bonus* is similar to that for setting *annual bonus rates*. Rates of *interim bonus* may be changed during the year if *supportable* rates change *significantly*.

Any changes to the methodology of determining bonus rates, including *smoothing* policy, will be approved by the *Directors*, after receiving advice from the *With-Profits Actuary* and from the *RLSF Supervisory Committee* as appropriate. The bonus policy will be reviewed regularly to ensure it remains appropriate.

2.3 Final bonus methodology

The *Directors* currently set final bonus rates for death claims and maturities for conventional with-profits endowment and pension policies based upon the characteristics of maturing policies. Rates are based upon any excess of the *asset share* calculated as set out in section 2.1.3 above over the *guaranteed benefits* plus any *interim bonus*. Rates are then subject to the *smoothing* policy described in section 2.4 below.

Final bonus scales for deaths under conventional with-profits whole of life policies are determined using a slightly different approach. Supportable *final bonuses* are calculated as any positive excess of the *asset share* calculated as set out in section 2.1.3 above for policies in force over the *guaranteed benefits* plus any *interim bonus* allowing for the probability of death in the following year.

Where there are no *material* differences, final bonus rates for whole of life policies are set to be the same as for appropriate endowments maturing after a term equal to the duration in force at the most recent policy anniversary of the whole of life contract. Where differences are *material*, separate scales are used for whole of life business. The scales are subject to the *smoothing* policy described in section 2.4 below.

Final bonus rates for U.K. and Irish policies of the same type may differ depending upon the level implied by the analysis described above.

Final bonus rates are set to ensure that an overwhelming majority of maturity payouts are expected to fall within the ranges published in section 2.1.2.

Separate final bonus rates are not calculated for surrenders for *conventional with-profits policies* since, in general, surrender values are based on *asset shares*.

The *Directors* currently set final bonus rates for death claims and maturities for *unitised with-profits policies* as any positive excess of the *asset share*, calculated as set out in section 2.1.3 above, over the *face value of units*, subject to the *smoothing* policy described in section 2.4 below. Hence full weight is given, subject to *smoothing*, to recent economic experience up to the point at which final bonus rates are calculated.

The *Directors* currently set final bonus rates for surrenders for *unitised with-profits policies* as any positive excess of the *asset share*, calculated as set out in section 2.1.3 above, over the *face value of units*, subject to the *smoothing* policy described in section 2.4 below. (A surrender penalty may also apply.) Hence full weight is given, subject to *smoothing*, to recent economic experience up to the point at which final bonus rates are calculated.

Market Value Reductions for surrenders of *unitised with-profits policies* are set as any shortfall of the *asset share*, calculated as set out in section 2.1.3 above, over the *face value of units* plus any *final bonus* minus any *surrender penalty*, subject to the *smoothing* policy described in section 2.4 below.

The *Directors* currently expect to set final bonus rates once a year for *conventional with-profits policies* and monthly for *unitised with-profits policies*, but may do so more or less frequently. Final bonus rates will be set at least once every 13 months. *Significant* unexpected changes in the underlying *asset shares* caused by a changing economic environment would cause final bonus rates to be changed more frequently. More frequent changes to final bonus rates might occur if the current final bonus rates appear likely to endanger the financial strength of the *fund* or if the proportion of policies expected to fall within the specified maturity range (described in section 2.1.2) falls below 90%.

2.4 Smoothing methodology

The amounts by which maturity payouts on similar *conventional with-profits policies* with a similar term vary from one year to another may be smoothed. In general the degree of *smoothing* is slight. The ability to apply *smoothing* depends, among other things, upon the financial strength of the *fund* (and hence the size of the *inherited estate*), and the expected cost of *smoothing*.

For example, where the financial position of the *fund* has weakened over a period and payouts have exceeded *asset shares* in that period then a greater reduction in corresponding payouts is likely to be applied in the following period to align those payouts more closely with *asset shares* than would otherwise be the case. Similarly, where the financial position of the *fund* has improved and payouts had been below *asset shares* then a greater increase in payout may be applied to align those payouts more closely with *asset shares* than would otherwise be the case. Where the payout is significantly above or below *asset share* then a larger change in the corresponding payout may be required in subsequent periods to align such payouts more closely to *asset shares*.

The degree of *smoothing* currently applied to surrender values for *conventional with-profits policies* and to payouts on *unitised with-profits policies* is only slight and payouts follow *asset shares* more closely than for maturity payouts on *conventional with-profits policies*.

Surrender bases for *conventional with-profits policies* previously transferred to *Royal Liver* are based on the surrender formulae at the time of transfer, as required under the terms of transfer, resulting in heavier *smoothing*.

The *Directors* do not stipulate any fixed period over which they expect *smoothing* to be neutral for any type of claim. Payouts may be adjusted as rapidly as is necessary to protect the financial strength of the *fund*.

There is no explicit maximum accumulated cost of, nor maximum surplus arising from, *smoothing*. However, the *Directors* aim to strike an appropriate balance between the reasonable benefit expectations of *with-profits policyholders* exiting the *fund* and those whose with-profits investment continues. A consistent approach is applied between different classes and generations of policyholder.

The *Directors* apply the same *smoothing* strategy to all generations of *with-profits policy*. *Conventional with-profits policies* and *unitised with-profits policies* have different *smoothing* strategies.

Market Value Reductions on *unitised with-profits policies* are reviewed monthly or more frequently.

Where a *unitised with-profits policy* is partially surrendered at a guaranteed *no MVR date,* the *asset share* is reduced in proportion to the *face value of units* that are surrendered. The remaining *asset share* is then used in determining subsequent claim values in the same way as for policies that have not had partial surrenders.

2.5 Investment strategy

The investment strategy of the *fund* is set by the *Directors* on the basis of the assets of the *fund*; no reliance is placed on the potential or actual provision of capital support from outside the *fund*.

The investment strategy will be reviewed and formally approved by the *Directors*, taking into account the advice of the *With-Profits Actuary*, at least once in any fifteen-month period. The *Directors* set guidelines for the proportion of the *fund* that may be invested in particular asset classes or in individual securities or companies. The *Directors* also set performance benchmarks against which the returns achieved on the individual asset classes are measured. The *Directors* regularly monitor performance against the benchmarks.

The investment mix is formally monitored periodically, normally every month or more frequently if market conditions dictate.

Linked liabilities under unit linked policies are matched by assets in the relevant internal linked fund.

Non-linked non profit business and non-unit realistic reserves under linked policies are backed by a diversified portfolio of fixed interest assets of suitable outstanding term and cash on deposit.

With-profit liabilities business is backed by a diversified portfolio of assets, although account is taken of the level of guarantees in choosing these assets. The asset mix may vary for ordinary branch and industrial branch business, United Kingdom and Republic of Ireland business, and by product type. The asset mix backing the relevant with-profits business may also vary according to the level of *guaranteed benefits* relative to the *asset shares*, the term since the start of the policy and the remaining term to the maturity or vesting date.

The *inherited estate* is also backed by a diversified portfolio of assets.

Following the closure of the *fund* to new business the in-force portfolio will run down over time as claims are paid, and there will be a gradual distribution of the remaining *inherited estate*. The *Directors* will need to strike a balance between retaining *inherited estate* to maintain investment freedom for continuing *with-profits policies* and paying out a *fair* share of *inherited estate* in the form of additional benefits to exiting policyholders. Over time this together with the changing profile of business in force may result in a greater proportion of the assets backing with-profits policies being invested in fixed interest investments and cash than has been the case historically.

Short term liquid assets such as cash are held in order to meet amounts due where they are largely known and are payable in the short term.

Actuarial modelling of assets and liabilities is used to assess the risks of different asset allocations, and to set maximum and minimum percentages of the *fund* for each main asset type.

The guidelines set by the *Directors* for the proportion of the *fund* that may be invested in particular asset classes take into account the financial strength of the *fund*.

The *fund* may hold derivative instruments to provide backing for certain guaranteed liabilities within the *fund* and for the purpose of efficient portfolio management.

The investments currently permitted in the *fund* are all listed and unlisted U.K. and international securities (for example equities, government and other fixed interest or variable interest stocks, convertibles, warrants and subsidiary companies), collective investments, property, cash and other money market instruments. Assets may be held that are not investment grade and/or not traded on an exchange.

In considering individual investments different credit and liquidity qualities will be taken into account. A minimum level of liquidity will be set based on the expected cashflow profile of the liabilities.

No investment weighting within the *fund* will be greater than twice that allowed under the admissibility rules or any other regulatory requirement.

No more than 5% of fixed interest securities may be held in assets that are not investment grade. No more than 5% of assets may be held in securities that are not traded on an exchange.

The *fund* does not expect to invest in any new or novel investment instruments. Any such investments will be undertaken only after:

- obtaining appropriate advice
- understanding the risk and commercial implications of such investments
- ensuring such investment is compatible with the investment strategy, and
- obtaining the approval of the *Directors*.

Assets that would not normally be traded are those used in the management of the business, typically buildings, plant and equipment. The change in value of some of these assets, typically buildings, forms part of the overall investment return at which the *asset shares* used in determining claim values are accumulated.

The assets of the *fund* are managed by a wholly owned subsidiary of *Royal London*, *RLAM*, which invests those assets within guidelines set by the *Directors* and detailed in an investment management agreement. The *fund* may invest in a range of trusts and *OEICs* managed by *RLAM*.

The *fund* may invest in commodities, infrastructure financing or insurance related investments to provide credit diversification within the *fund*. Investment in any of these classes is only permitted after following the approval process in force.

2.6 Business risk

The business risks of the *fund* include exposure to maintaining with-profits and non profit policies.

The *fund* is closed to new business, other than that arising on the exercise of options attaching to existing policies to effect premium increments, additional benefit coverage or additional policies. Business risks arising from the writing of new business are therefore limited.

The exposure of the *fund* to future changes in the level of expenses is limited by the *Royal Liver Instrument of Transfer* (see section 2.7).

Any excess of expenses charged to the *fund*, guarantee costs and benefit costs over those charged directly to *asset shares* form part of the *miscellaneous profits or losses* that may be allocated to *asset shares* at the discretion of the *Directors*.

The current risk strategy limits the taking on of business risk so as to avoid any single risk or aggregation of risks whose occurrence would cause a *material* impairment to the financial strength of the *fund*.

Mortality risk is managed in accordance with underwriting and reinsurance standards set by the Chief Actuary. Consideration is given to models of possible future mortality experience.

The profits or losses from non profit business are also part of the *miscellaneous profits or losses* that may be allocated to *asset shares* at the discretion of the *Directors*.

Smoothing is applied to payouts rather than the underlying components of *asset shares* such as any allocation of the profits or losses from business risks.

There is no minimum level which profits or losses from business risks must exceed before they are included in the *miscellaneous profits or losses* which may be allocated to *asset shares* at the discretion of the *Directors*.

The profit or loss from all business risk may be pooled across all generations and classes of *with-profit policies* at the discretion of the *Directors*.

2.7 Charges and expenses

This section summarises the current methodology. The methodology may have been different or carried out more approximately in the past. Past methodology may have been different under the legal terms of a previous transfer to *Royal Liver*.

The expenses to be charged to the *fund* are set out in the *Royal Liver Instrument of Transfer*.

In particular:

- per policy expenses will be fixed for a period of 10 years and 5 months from the date of transfer to *Royal London*, subject to increases, firstly on 1 December 2012 and annually thereafter, made by reference to specified inflation indices;
- the per policy expenses that may be charged to the *fund* thereafter will not be materially greater than those which would be incurred using a third party administrator (allowing for the cost of migrating administration to the third party);
- a charge of 0.26% per annum of funds under management will apply.

Certain other costs, such as liabilities arising before the transfer to *Royal London* and certain costs of integrating the businesses of *Royal Liver* and *Royal London*, are also chargeable to the *fund*.

All types of expenses incurred by the *fund* are apportioned to all major classes of *with-profits policy* and non profit policy. Amounts are charged to *asset shares* of *with-profits policies* as follows.

At the Directors' discretion, some expenses incurred by the *fund* may in the first instance be charged to the *inherited estate*. Any such expenses may subsequently be charged to *asset shares*.

For Royal Liver *conventional with-profits policies* and policies previously transferred to *Royal Liver* from Friends' Provident that are not *LM policies*, investment expenses and other maintenance expenses are charged as a combination of a percentage of the *asset share* and a per policy amount.

Surrender expenses may be charged to surrendering policies in order to protect remaining policyholders.

For Royal Liver *unitised with-profits policies* maintenance expenses are charged as a combination of a percentage of the *asset share* and a per policy amount (which depends upon whether premiums continue to be paid on the policy).

For Irish Life policies and *LM policies* the maintenance and investment expenses deducted from *asset shares* are in the same form as for Royal Liver conventional with-profits Industrial Branch policies described above, except that until 31 December 2011 the aggregate expenses charged to Irish Life policies in any calendar year are subject to a cap specified in the relevant scheme of transfer. The cap is calculated as the sum of (i) 35.4% of the premiums received in the year, (ii) 0.13% of the *asset shares* of Irish Life policies at the end of the year (calculated iteratively if necessary) and (iii) €6.64 per policy inflated from 31 December 2001 at the rate of price inflation in Ireland plus 1% per annum.

For Caledonian Insurance policies the maintenance and investment expenses deducted from *asset shares* are in the same form as for Royal Liver Ordinary Branch *conventional with-profits policies* described above.

2.8 Management of the inherited estate

The *inherited estate* is currently used to provide capital for the following:

- short term *smoothing* costs where payouts are in excess of 100% of *asset share*;
- the new business strain, in respect of recent new business, of setting up statutory reserves at the start of the policy when the premiums received are less than the expenses incurred in respect of non profit business or expense allowances charged to *asset shares* in respect of with-profits business;
- to cover the *fund*'s *Regulatory Capital Resource Requirements*.

Short term *smoothing* costs are expected to be repaid from subsequent *smoothing* excesses. New business strain is expected to be repaid as further premiums are received. Hence neither of these is expected to result in a permanent reduction in the size of the *inherited estate*.

The *inherited estate* is currently meeting the following costs to the extent that they arise:

- the difference between guarantee costs and guarantee charges;
- differences between the expenses charged to the *fund* determined in accordance with the *Royal Liver Instrument of Transfer* and the expenses charged to *asset shares*; and
- the difference between the tax charged to the *fund* and the tax charged to *asset shares*.

Current practice is to maintain the *inherited estate* broadly at the level necessary to support the *smoothing* policy of the *fund*, and to cover its *Regulatory Capital Resource Requirements*. This level will vary as the size of the business varies.

If the *inherited estate* increases above the level needed to achieve the aims set out in section 1.8 above then the *Directors* would decide to make a discretionary allocation from the *inherited estate* to the *asset shares* of eligible policies.

The *Directors* are unlikely to distribute any *inherited estate* unless they are satisfied that the assets of the *fund* are sufficient to withstand any reasonably foreseeable adverse event and continue to cover its *Regulatory Capital Resource Requirements* determined in those changed circumstances but ignoring the ability to remove previously added enhancements from the *inherited estate* or to otherwise reduce *asset shares*.

LM policies are not entitled to participate in any discretionary allocations from the *inherited estate*.

In the event that a discretionary allocation from the *inherited estate* is to be made to the *asset shares* of *with-profits policies* other than *LM policies* then a discretionary allocation will also be made to *contingent reversionary bonus policies*. Any discretionary allocations of *inherited estate* to *contingent reversionary bonus policies* will be on a contingent basis, and will be removed in the same circumstances that such allocations are removed from the *asset shares* of *with-profits policies* other than *LM policies*.

If the *inherited estate* falls below the level needed to achieve the aims set out in section 1.8 above then the possible management actions that could be taken include, but are not necessarily limited to, the following:

- allocate fewer *miscellaneous profits* or more *miscellaneous losses* to *asset shares*;
- change the asset mix to increase the proportion invested in fixed interest investments and cash;
- tighten the *smoothing* policy limits to reduce *smoothing* costs over the next year;
- reduce *annual bonuses* at a faster rate than in normal circumstances, and possibly to zero;
- change the assets backing policies so that they vary according to the type of policy, the level of *guaranteed benefits* relative to *asset shares* and/or the term since the start of the policy or the term to *maturity*;
- introduce further guarantee charges;
- introduce charges for the cost of capital;
- remove any past discretionary allocation to *asset shares* of eligible policies from the *inherited estate*.

The combination of actions to be taken will be approved by the *Directors*, after receiving advice from the *With-Profits Actuary* and from the *RLSF Supervisory Committee* as appropriate.

If the assets of the *fund* are insufficient to cover its *Regulatory Capital Resource Requirements* determined after allowing for the ability to remove previously added enhancements from the *inherited estate*, but ignoring the ability to reduce *asset shares*, then the *Directors* are likely to remove all such previously added enhancements.

The *Directors* would apply additional deductions from *asset shares* if necessary in certain adverse circumstances either:

- to ensure the value of realistic assets exceeds the value of the technical provisions of the *fund*; or
- to ensure the *fund* is able to cover its *Regulatory Capital Resource Requirements* and is still able to pay *guaranteed benefits*.

Any such additional deductions may not be levied on the *asset shares* of *LM policies* until the *asset shares* of other *with-profits policies* have been reduced to the level of *guaranteed benefits*.

No discretionary allocations from the *inherited estate* to the *asset shares* of *with-profits policies* that are not *LM policies* may be made until the *asset shares* of *LM policies* which remain invested in with-profits have been increased to remove any additional deductions applied to those *asset shares*.

If, after *asset shares* have been reduced so that only minimum *guaranteed benefits* are payable, the *fund* still has a shortfall of its realistic assets relative to its technical provisions, then that shortfall would be met by the *RL Main Fund*. In no circumstances would payouts be less than the *guaranteed benefits*.

The *Directors* would aim to implement management actions in an orderly fashion over a period of time, where possible, before making deductions from *asset shares* and paying only *guaranteed benefits* should this ever be necessary.

2.9 Volumes of new business

The *Royal Liver Sub-Fund* is closed to new business, other than that arising on the exercise of options attaching to existing policies to effect premium increments, additional benefit coverage or additional policies.

Glossary

Annual bonus	An additional amount added to the *guaranteed basic sum assured on death* or *guaranteed basic sum assured on maturity* on an annual basis for a *conventional with-profits policy*, or the additional units added to a *unitised with-profits policy*, which is payable on a claim.
Annual bonus rate	The rate applied to the basic sum assured (if simple) and attaching *annual bonuses* (if compound) to calculate the amount of *annual bonus* added in the year.
Asset share	A basis for guiding the determination of payouts to *with-profits policyholders* on death, *maturity* and surrender. This is based upon an accumulation of individual policy cashflows. The current method of calculation is set out in the Practices.
CIS	Co-Operative Insurance Society Limited
Contingent reversionary bonus policy	A premium paying industrial branch policy, or one which has paid its full contractual premiums, for which the *Directors* at their discretion may declare a contingent *final bonus*.
Conventional with-profits life policy	A *with-profits policy* which is treated as life business for taxation for which the benefits are expressed in the form of *guaranteed benefits* plus discretionary *interim bonuses* and *final bonuses*.
Conventional with-profits pension policy	A *with-profits policy* which is treated as pensions business for taxation for which the benefits are expressed in the form of *guaranteed benefits* plus discretionary *interim bonuses* and *final bonuses*.
Conventional with-profits policy	A *conventional with-profits life policy* or a *conventional with-profits pension policy*.
Converted with-profits pension policy	A policy which was converted from a *conventional with-profits pension policy* to a *unitised with-profits policy* during the period September 1999 to October 2000.
Directors	The Directors of *Royal London* from time to time.
Face value of units	The current bid value of the units (including any attaching bonus units but excluding *final bonus*

	units that may be added at the date of claim) attaching to a *unitised with-profits policy*.
Fair, fairly, fairness	References to and use of the concept of fair, fairness or treating policyholders fairly in this document relates to the obligation created by Principle 6 of the *Regulator's* Principles for Businesses to, amongst other things, treat customers fairly.
FCA	Financial Conduct Authority
Financial Adjustment	Some policy conditions refer to Market Value Reduction factors as Financial Adjustments. In this PPFM we use our preferred terminology of Market Value Reduction factors throughout.
Fund	The *Royal Liver Sub-Fund*.
Guaranteed basic sum assured on death	The amount set out in the policy schedule and any attaching endorsements that will be paid on death before the addition of any bonuses. This includes any sum assured purchased by Life Assurance Premium Relief (LAPR).
Guaranteed basic sum assured on maturity	The amount set out in the policy schedule and any attaching endorsements that will be paid on *maturity* before the addition of any bonuses. This includes any sum assured purchased by Life Assurance Premium Relief (LAPR). For pension business this includes guaranteed basic pension.
Guaranteed benefits	For *conventional with-profits policies* on *maturity* or death it is the aggregate of the *guaranteed basic sum assured on death* or the *guaranteed basic sum assured on maturity* and any attaching *annual bonus*. For *unitised with-profits policies* on *maturity* or death it is the face value of the units attaching to the policy. For *with-profits policies* on surrender it is the amount, if any, set out in the policy terms and conditions.
Guaranteed minimum death benefit	The minimum amount of death benefit set out in the policy schedule and any attaching endorsements. This overrides the *guaranteed basic sum assured on death* plus bonuses.
Inherited estate	An amount representing the fair market value of the assets of the *fund* less the technical provisions (determined before allowing for the requirement to distribute the inherited estate

	over the remaining lifetime of the *with-profits policies* of the *fund*).
Interim bonus	An addition to a claim value in or for a period for which no declaration of *annual bonus* has yet been made.
LM policies	*With-profits policies* that were originally transferred from Friends' Provident (London and Manchester) Assurance Limited to Friends' Provident Life Office and then to *Royal Liver*.
Long term, longer term	The *Directors* will decide what is long term having taken advice from the *With-Profits Actuary*. Different interpretations may apply in different contexts simultaneously.
Lower Capital Threshold	The level specified in the *Royal Liver Instrument of Transfer* such that if the capital of the *fund* falls below this level actions are taken to reduce or remove enhancements previously made to *asset shares* of *with-profits policies* and contingent bonuses previously allocated to *contingent reversionary bonus policies*.
Market Value Reduction	A reduction made to the *face value of units* under a *unitised with-profits policy* in certain circumstances provided for in the policy conditions. This may be referred to as a Market Value Adjustment by some life offices.
Material, materially	The *Directors* will decide what is material having taken advice from the *With-Profits Actuary*. Different interpretations may apply in different contexts simultaneously.
Maturity	The termination of a policy due to it reaching the contractual end date. For pension policies this includes retirement.
Maximum death benefit	The maximum amount payable on death set out in the policy schedule and any attaching endorsements. This overrides the *guaranteed basic sum assured on death* plus bonuses. Examples include, but are not limited to, a return of premiums on death before age 10 on some Royal Liver Ordinary Branch and Industrial Branch business in the United Kingdom; a maximum of €787.56 for some Royal Liver Ordinary Branch and Industrial Branch business in the Republic of Ireland.
Minimum Capital Threshold	The level specified in the *Royal Liver Instrument of Transfer* such that if the capital

	of the *fund* falls below this level actions are taken to make deductions from *asset shares* of *with-profits policies* in order to increase, to the extent possible, the capital of the *fund* to the Minimum Capital Threshold level calculated allowing for those deductions.
Miscellaneous profits or losses	These may include, but need not be limited to, profits or losses on non profit business, profits or losses from business ventures, surrender profits or losses on with-profits business, the difference between guarantee costs and guarantee charges, the difference between tax charged to the *fund* and tax charged to *asset shares*, reinsurance profits or losses, and the investment return on the *inherited estate*.
No MVR date	A date at which it is guaranteed that no *Market Value Reduction* will be applied.
Non profit	Policies which do not participate in the profits of the *with-profits fund*.
OEIC	Open-ended investment company.
PLAL With-Profits Sub-fund	The fund into which certain assets and liabilities of Phoenix Life Assurance Limited were transferred with effect from 29 December 2008, a separate closed sub-fund of the *RL LTF*.
Predecessor Schemes	means each of: * the Caledonian Scheme, under which business of Caledonian Insurance Company Limited was transferred to *Royal Liver* with effect from 31 December 2000; * the Friends' Provident Scheme, under which business of Friends' Provident Life Office was transferred to *Royal Liver* with effect from 31 March 2001; * the CSAAS Scheme, under which business of the Civil Servants' Annuities Assurance Society was transferred to *Royal Liver* with effect from 19 December 2001; and * the Irish Life Scheme, under which business of Irish Life Assurance plc was transferred to *Royal Liver* with effect from 28 February 2002.
PRA	Prudential Regulation Authority
Prize Bond	A bond issued by the Irish Government which may be redeemed at par at any time, and which is eligible to receive varying levels of cash prize in a monthly draw. All monies received from a winning prize bond are paid in cash to the holder of the policy to which that bond is

	allocated, shortly after the prizes are announced.
Prudent	The *Directors* will decide what is prudent having taken advice from the *With-Profits Actuary*. Different interpretations may apply in different contexts simultaneously.
Regulator	The *FCA*, *PRA* or any other regulatory body as defined in accordance with the provisions of the UK Financial Services and Markets Act 2000 (or any such legislation that supersedes it).
Regulatory Capital Resource Requirements	The capital resources that *Royal London* must hold in respect of the *fund* determined in accordance with regulatory requirements from time to time, but subject to the asset admissibility limits being measured by reference to London's long term business amount
RLAM	Royal London Asset Management Limited.
RLCIS	Royal London (CIS) Limited – the name given to *CIS* following its acquisition by *Royal London*.
RL LTF	The Royal London Long Term Fund which consists of the *RL Main Fund*, the *SL Closed Fund*, the *PLAL With-Profits Sub-fund* and (from 1 July 2011) the *Royal Liver Sub-Fund*.
RL Main Fund	The Royal London main fund which includes Industrial Branch and Ordinary Branch business originally issued by *Royal London*, United Friendly Insurance plc and Refuge Assurance plc.
RLSF Supervisory Committee	The committee which has responsibility for advising the Directors on the operation of the *fund*. The RLSF Supervisory Committee has been established in accordance with the *Royal Liver Instrument of Transfer*. It consists of 5 members, three of whom (including the chairman) are independent of *Royal London*. The RLSF Supervisory Committee's role is to monitor the management of the *fund* with the aim of ensuring it operates in accordance with the terms of the *Royal Liver Instrument of Transfer* (including the Core Principles of Financial Management in that document) and the Principles and Practices of Financial Management of the *fund*.
Royal Liver	Royal Liver Assurance Limited

Royal Liver Instrument of Transfer	The legal document governing the transfer of the business of *Royal Liver* to *Royal London*.
Royal Liver Sub-Fund	The fund into which certain assets and liabilities of Royal Liver Assurance Limited were transferred with effect from 1 July 2011, a separate sub-fund of the *RL LTF*.
Royal London	The Royal London Mutual Insurance Society Limited.
Royal London (CIS) Sub-Fund	The fund into which certain assets and liabilities of *RLCIS* were transferred with effect from 30 December 2014, a separate closed sub-fund of the *RL LTF*.
Royal London Group	*Royal London* and its subsidiaries
Sample model point asset shares	These are typically determined by averaging asset shares calculated for policies grouped together by bonus series, duration (or, for whole of life policies, year of entry and age at entry) and policy conditions. The sample model point asset shares are used as a basis for guiding the determination of payouts to *with-profits policyholders* on death, maturity and surrender.
Significant	The *Directors* will decide what is significant having taken advice from the *With-Profits Actuary*. Different interpretations may apply in different contexts simultaneously.
SL Closed Fund	The fund into which certain assets and liabilities of The Scottish Life Assurance Company were transferred with effect from 1 July 2001, a separate closed sub-fund of the *RL LTF*.
Smoothing	The process by which payouts are adjusted when the value of the underlying target changes. Smoothing cost is the excess of the actual payout over the greater of the theoretical target payout and the *guaranteed benefits*. Smoothing excess is the shortfall of the actual payout from the theoretical target payout.
Solvency	This is the ability of the *fund* to meet its *Regulatory Capital Resource Requirements*.
Supportable	In the context of *annual bonus rates* this means affordable in the sense that the *asset share* at the time of claim is expected on prudent assumptions as to future experience to be greater than the *guaranteed benefits* including future *annual bonuses* at the supportable rate.

Surrender penalty	A deduction from the face value of units for surrender claims as set out in the policy conditions for *unitised with-profits policies*.
Final bonus	An additional amount that may be added to the *guaranteed benefits* at the time of a claim.
Unitised with-profits policy	A *with-profits policy* for which the benefits are expressed in the form of the *face value of units* plus discretionary *final bonuses*, minus *surrender penalty*, minus *Market Value Reduction*. This type of policy can also be referred to as an accumulating *with-profits policy*.
Upper Capital Threshold	The level specified in the *Royal Liver Instrument of Transfer* such that if the capital of the *fund* exceeds this level actions are taken to make enhancements to *asset shares* of *with-profits policies* and allocations of contingent bonuses to *contingent reversionary bonus policies*.
With-Profits Actuary	An actuary who is a Fellow of the Institute and Faculty of Actuaries who is appointed by the *Directors* to advise on the Principles and Practices of Financial Management in respect of the *fund*. The *Directors* may seek advice from another actuary in addition to the With-Profits Actuary.
With-profits policy	A policy which participates in the profits of the *fund*. This participation may be in the form of one or more of a cash bonus, an *annual bonus* or a *final bonus*.
With-profits policyholder	A policyholder of the *fund* who holds a *with-profits policy*.