A guide to how we manage with-profits policies in the German Bond Sub-Fund

7 February 2019

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1 About this guide

This guide tells you how we manage the with-profits policies in the German Bond Sub-Fund, "the Fund". Policies in the Fund were transferred from The Royal London Mutual Insurance Society Limited ("Royal London") to Royal London DAC on 7 February 2019. References in this guide to "we" and "us" are to Royal London DAC.

On transfer policies in the Fund were reinsured back to Royal London's Main Fund (the "Royal London Main Fund"), the fund they were in before the transfer. This means that although Royal London DAC is the insurer, Royal London is ultimately responsible for funding payment in relation to claims made on policies in the Fund.

The reinsurance arrangement means that the management of the Fund is linked with the management of the Royal London Main Fund. The way the Royal London Main Fund is managed is described in its Principles and Practices of Financial Management ("Royal London PPFM") document. This is a technical document that describes in detail how the Royal London Main Fund is managed.

The content of the Royal London PPFM should be read as also applying, indirectly, to policies in the Fund. This guide covers the key points of the Royal London PPFM that are relevant to policies in the Fund but if you require more detail you can refer to the Royal London PPFM directly. You can read the Royal London PPFM on our website royallondon.ie or you can ask us for a copy.

If we make significant changes to our approach to managing the Fund or Royal London makes significant changes to its approach to managing the Royal London Main Fund that materially impact policies in the Fund, we will tell you and provide an updated copy of this guide and the Royal London PPFM.

This guide should answer most of the questions you might have on the management of the Fund. If you have any further questions, please contact us. You will find our contact details under question 12.

2 What is a with-profits' policy?

The with-profits policies in the Fund are unitised with-profits policies. A unitised with-profits policy is one in which we:

- use your premiums or contributions to buy units in a with-profits fund, and
- take units away to pay for our charges.

We aim to increase the return on your policy by adding bonuses. We guarantee to pay the value of the units you hold in the with-profits fund at certain times, for example on the date of death. We may also add a final bonus at this time.

However, in some situations we could pay you less than the value of the units allocated to your policy by applying a market value reduction. We explain this under question 11.

3 How do you decide the return on my policy?

We aim to make sure that every policyholder receives a fair return. We will calculate the return allowing for:

- the premiums paid into your policy
- the deductions we've needed to make to cover our expenses, the cost of providing benefits and tax, and
- the investment returns from the assets Royal London holds to back your policy.

Normally investment returns have the most significant impact on the return you get on your policy. We aim to increase the return on your policy by adding bonuses. We explain this under question 6. If you choose to cash in your policy, we aim to pay an amount that is within a reasonable range of the value of the investments backing the policy, before allowing for smoothing. This range is outlined in the Royal London PPFM. We explain smoothing under question 5.

4 What investments do you hold to back my policy?

The reinsurance arrangement means that the investments to back your policy are held by Royal London rather than Royal London DAC. Royal London aim to achieve growth by investing in a wide range of assets, subject to the requirement that the Royal London Main Fund should always be able to pay policyholders' guaranteed benefits when they are due (including those policyholders who have policies reinsured to the Royal London Main Fund). Holding a wide range of assets helps to reduce the risk to both the Royal London Main Fund and to the Fund that would otherwise arise if all or most of the assets were invested in a single category of assets. Investments include:

- shares in UK and overseas companies (also known as equities)
- property
- government bonds (loans to a government)
- company bonds (loans to companies)
- subsidiary companies
- cash deposits, and
- more complex types of assets that are used to help reduce investment risk or increase the diversity of the asset mix.

The assets of the Royal London Main Fund may be allocated to different types of policies in different ways. This is done to take account of a number of factors, such as the value and nature of policy guarantees. As a result, different types of policies might be invested in a different mix of assets.

Each year Royal London intends to publish on its website royallondon.com the investment mix at 31 December. This will also be published on our website royallondon.ie

5 How do you cushion my policy from the ups and downs of the stock market?

As we've explained under question 4, the Royal London Main Fund invests in a wide range of assets, including company shares, property and government and company bonds. Company shares are bought and sold on stock markets throughout the world. Although the investment returns from company shares and property are potentially higher than from government and company bonds, they are also less stable, with values fluctuating up or down over short periods. World events may cause the values of company shares to fall sharply.

We aim to cushion your policy as far as possible from day-to-day fluctuations in investments, by 'smoothing' out the effects of some of the ups and downs. We do this in two ways. Firstly, Royal London invests in a wide range of assets and, within these, limits the amount invested in any one specific investment. Secondly, instead of adding large bonuses to your policy in good periods and no bonuses in bad periods, we hold back some of the investment profit made in good periods and add it in the bad periods.

This means you receive a more 'smoothed' return on your policy. So if, for example, your policy ended on a day when the stock market fell substantially, the smoothing of returns might help to protect it from a sudden drop in value. Policyholders in funds that don't smooth investment returns could see the value of their policies rise or fall faster than those in a smoothed fund.

6 What affects my policy's bonuses?

The bonuses we may add to your policy are affected by:

- the investment returns achieved by the assets backing your policy
- the level of policy guarantees
- the charges that we make, and
- how we smooth the return on your policy (we explain smoothing under question 5).

The bonuses we may add to your policy represent your share of the profits and losses of the Royal London Main Fund. The main factor that affects the level of bonuses that we may add to different groups of with-profits policies is the investment profits or losses of the assets backing those policies.

Other important factors are the effect of policy guarantees and the charges we make. The charges include:

- the costs of administering your policy
- the costs of helping to meet policy guarantees
- the cost of life cover and
- tax.

Other factors may also give rise to profits or losses within the Royal London Main Fund that may be shared with you through distribution of the Royal London Main Fund estate. This is described under question 10.

7 What types of bonus might you add to my policy?

There are two types of bonuses.

- Regular bonuses, which we may add to your policy by increasing the unit price used to calculate the value of the units you hold.
- Final bonus, which we may add when your policy ends.

The benefits payable when you cash in your policy are the value of the units you hold plus any final bonus we may add. However, in some scenarios we may apply a market value reduction. We explain this under question 11.

8 How do you decide bonuses?

We set bonuses so that payouts represent a fair share of the Royal London Main Fund, allowing for smoothing. We explain smoothing under question 5.

Regular bonuses pay out part of the profits of the Royal London Main Fund, increasing your policy's unit value. We set regular bonus rates each year with the aim of holding back part of your policy's share of the profits to pay as final bonus.

When we set regular bonuses, we take account of factors such as our long-term view of future investment returns, the level of policy guarantees and the level of the estate in the Royal London Main Fund for its long-term objectives. We explain the estate under question 10.

Regular bonuses increase your policy's guaranteed benefits. In order to ensure that the Royal London Main Fund can pay such guaranteed benefits, we may limit future regular bonuses or set regular bonuses to zero.

Any final bonus that we add is intended to represent your policy's fair share of the profits and losses of the Royal London Main Fund over the policy's term that we haven't already added as regular bonuses.

In setting final bonuses, we also aim to ensure that both the Royal London Main Fund and the Fund are always large enough to pay policyholders' guaranteed benefits when they are due and have enough money in the estate. We explain about the estate in question 10.

We aim to set final bonuses so that, in total, maturity payouts are equal to their fair share of the Royal London Main Fund. Some final bonuses might be zero, for example when the guaranteed benefits are greater than the fair share.

9 What risks are there in investing in the Fund?

The Royal London Main Fund, and by association the Fund, are exposed to a number of risks, for example:

- risks relating to how well investments do
- risks relating to how much the expenses of the Fund might be
- risks that the costs of meeting policy guarantees are greater than we expect
- the risk that we might have to pay compensation to certain policyholders
- risks associated with operating subsidiary companies owned by the Fund and
- risks associated with business activities including selling new business (for the Royal London Main Fund only as the Fund is closed to new business).

We monitor the risks as part of our standard risk management procedures, and act to reduce risk exposure where we think it is necessary.

10 What is the Estate of the Royal London Main Fund and what is it used for?

The estate of the Royal London Main Fund is the amount by which the assets of the Royal London Main Fund are greater than the amounts already promised to policyholders by way of guaranteed benefits.

Royal London decides on the level of the estate required to help manage the Royal London Main Fund properly and support its operation. The estate is used to ensure the Royal London Main Fund has enough money to satisfy the regulators, develop the business, issue new business and carry out smoothing, for example.

If at any time the estate is more than Royal London thinks it needs, they may decide to reduce it by distributing some of the profits to eligible policies. This is called ProfitShare. Policies in the Fund are eligible for any such ProfitShare distributions through the reinsurance arrangement. They will be applied through bonuses added to your policy.

The Fund is a closed fund. However, the reinsurance arrangement ensures that your policy benefits are linked to Royal London's Main Fund which is an open fund. The estate of the Fund is to be used for the benefit of policies within the Fund, and policies in the Royal London Main Fund through the reinsurance. Royal London DAC shareholders are not entitled to share in the estate of the Fund.

11 How do you decide how much I get if I choose to cash in my policy?

If you choose to cash in your policy, we may adjust your benefits to pay you a fair amount taking into account factors such as the level of expenses and investment returns over the period that you held the policy for and allowing for smoothing. We explain smoothing under question 5.

This means we may reduce the value of your units by applying a market value reduction (MVR) if you choose to cash in your policy. We may apply this reduction to ensure a fair level of payouts to everyone invested in the Royal London Main Fund. If we did not do this the policies remaining in the Fund or the Royal London Main Fund would not receive their fair share. We won't apply an MVR when we cash in the units in your policy after the life assured dies.

12 How can I find out more?

If you have any questions, please:

Call us on 00 44 1624 681831 between 8am and 4pm Monday to Friday, unless it's a bank holiday in England.

Email us at olab@rl360.com

Or write to:

Royal London, International House, Cooil Road, Douglas, Isle of Man IM2 2SP

If you would like a copy of this document in large print, please call us on 00 44 1624 681831

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