Report of the Board to With-Profits Policyholders 2013-14

FCA Rules require the Directors of LICI to report to the with-profits policyholders of its UK Branch on how their interests have been looked after during the year. This report covers the period 1st April 2013 to 31st March 2014, the last full financial year for LICI.

In April 2005 LICI published its Principles and Practices of Financial Management (PPFM). These set out the way in which the company intends to manage its with-profits business and how it ensures that customers are treated fairly. A consumer-friendly version of the PPFM is also available on our website. You can also request a copy from us.

There were no changes made to the PPFM or to its consumer friendly version during the year except changing the name of the UK financial regulator from earlier FSA to PRA and FCA.

The Branch has a With Profits Actuary (WPA) to report to the Board regarding compliance with the PPFM during the year. The Branch also has an independent adviser in with-profits matters to advise the Board on the exercise of discretion. A statement from the WPA is included at the end of this report.

This report follows the various sections in the PPFM.

Over-riding principles

The Branch has four key financial objectives. These are:

(a) To meet the contractual obligations to policyholders

(b) To meet the tests of solvency and capital adequacy as required by regulatory bodies

(c) To treat policyholders fairly and meet the reasonable expectations of with-profits policyholders

and

(d) Subject to (a), (b) and (c), to maximise the financial returns to with-profits policyholders and the shareholders.

During the period the Branch has ensured that all contractual obligations are met and has comfortably met the various regulatory capital requirements at the end of the financial year. The Branch has also ensured that it has treated its policyholders fairly by paying them the claim values in accordance with its bonus policy.

Amounts payable

Asset shares show the amount the premiums paid by policyholders would have accumulated to, allowing for the investment return achieved by the Branch and deducting a share of the expenses of the Branch and allowing for the cost of any risk benefits.

The Branch previously used specimen asset shares to determine payouts. The Branch has developed a new asset share model and is now able to refer to individual policy asset shares for each policy (except ISA contracts) within the Branch with-profits portfolio. The individual policy asset shares have been used to assess whether payouts are falling within the target range in the PPFM.

Rules concerning payouts effective from 1st January 2006 require the Board to set target ranges for payouts and to ensure that most payouts fall within that range. These ranges are 80% to 120% of asset share for maturing policies and 75% to 115% for policies which surrender.

The Branch has been in a situation for a number of years where, for policies sold prior to April 2004, the guaranteed benefits exceeded their respective asset share. As the sums assured and attaching declared reversionary bonuses are already guaranteed these cannot be changed. Over recent years, new declared bonuses have been reduced to rectify this situation. However payouts exceed the asset shares for these policies. The proportions with payouts within the target ranges are greater than the 90% required by the PPFM for all policies except anticipated endowments and, due to the high guarantees, have been for a number of years.

Previously, the Board approved changes to the surrender value basis for certain policies based on the recommendation of the then actuary.

The individual policy asset shares will need to be incorporated into the calculation of surrender values and to assess whether surrender value payouts are falling within the target range in the PPFM.

Annual and final bonuses

Keeping in view the investment climate, annual bonuses for conventional business have been kept at the same levels for the year ending 31st March 2014. These rates will be supported on achieving targeted investment performance.

In addition, comparison of the asset share calculations referred to above with sum assured and reversionary bonuses to date show that terminal bonus cannot be justified for nearly all policy groups close to maturity. This is due to high annual bonuses granted in the past.

Due to low UK government bond yields during first half of the financial year, the reversionary bonus rate for ISA contracts remained at 0.25% from 1st April 2013 to 30th September 2013. However, the second half of the fiscal 2013-14 saw a rise in the gilt yield and accordingly the reversionary bonus rate for ISA contracts was revised to 0.75% from 1st October 2013 to 31st March 2014. The terminal bonus rates for ISA contracts have been determined using sample policy asset shares and payouts. A range of terminal bonus rates are calculated based on date of commencement of the contract. The reversionary and terminal bonus rates for ISA contracts have been calculated in line with the PPFM

Smoothing

The UK Branch aims to smooth the fluctuations of investment return and other sources of surplus over the period of the contract. The high proportion of the fund invested in fixed interest securities has meant that LICI's investment returns have not fluctuated as much as those of other with-profits funds. LICI has also aimed to reduce bonuses gradually over a period rather than cut them sharply in any one year. Payouts have been managed down slowly over the last few years rather than making large cuts in a particular year.

This year also the reductions in payouts on a group of sample regular and single premium endowment policies for terms of 10, 15, 20 and 25 years are between 1% and 5%. This, as explained earlier, is due to higher annual bonuses declared during earlier years.

The change in asset shares values for the same sample policies during the year is dependent on both term and whether a policy is a regular or single premium policy. The change in asset share values is calculated using the new individual policy asset share model. Asset share values were on average 2% lower. This is due to the implementation of the new individual policy asset share model which fully allows for all sources of surplus or strain within the with profits fund.

No market value reduction (MVR) has been applied to the ISA contracts during the financial year 2013-14.

Investment policy

The Branch's investment policy delegates investment decisions to Investec Wealth & Investment Management Ltd. The Board believes the fund manager provides a satisfactory level of service. The Board also believes that the investment practice has been in line with the investment policy as specified in the PPFM. The Branch's investment policy allows for investment in UK equities, overseas equities, bonds and deposits within the following ranges:

Asset Class	Range	Asset allocation as at 31 March 2014
UK Equity Shares	0-36%	27.78%
Overseas Shares	0-13%	9.68%
Fixed Interest	55-100%	59.30%
Cash	0-10%	3.24%

Business Risks

The Branch is managing its business risks in line with the PPFM. It is also managing the agreement with Wapeka Ltd to ensure that good quality service is provided to the Branch and its customers.

Expenses and Charges

The expenses of running the business have been charged to policyholders' asset shares except those subsidised by the shareholder.

Transfer to shareholders

The distribution of surplus is governed by section 28 of the Life Insurance Corporation Act 1956 (of India); this section is amended by Indian Parliament; the amendments are effective from 31.3.2012. The amended section of the Act provides that 90% or more of such surplus, as the Government of India may approve, shall be allocated to or reserved for the policyholders.

For the year 2013-2014, the Government of India has allowed 95% of surplus to be allocated to the policyholders.

Changes to the PPFM

There has been no change made to the PPFM during the year except changing the name of the UK financial regulator from earlier FSA to PRA and FCA.

Other issues

The Branch's management expenses reduced compared to the previous financial year. There is a fall in new business sales mainly due to the implementation of Retail Distribution review (RDR), the new regulatory requirements for distribution of retail investment products that came into effect from 1st January 2013.

The Board, in consultation with the AFH, WPA and the Government of India, is exploring various options for the Branch, while keeping the best interest of policyholders in mind.

The Board is ensuring that progress is made on the issues highlighted by the With-Profits Actuary in his report to the Board.

Summary

Having reviewed the period in question, the Directors are pleased to report to the with-profits policyholders that in its opinion the affairs of the Branch have been managed in accordance with the firm's PPFM and that the interests of these policyholders have been looked after in a satisfactory manner.

Report of the With Profits Actuary to Policyholders of the UK Branch of Life Insurance Corporation of India

I have made a report to the Board in accordance with the requirements of the Supervision Manual of the Financial Conduct Authority (FCA) Handbook to inform them of my view of the way in which the Principles and Practices of Financial Management (PPFM) has been applied and how discretion has been exercised in respect of the with profit policyholders.

I am also required by the Supervision Manual to draft a report to with profit policyholders to accompany the firm's annual report required by COBS20.4.7R, stating whether, in my opinion, the discretion exercised by the firm in respect of the period covered by the report may be regarded as taking the interests of the firm's with profit policyholders into account in a reasonable and proportionate manner. In doing this, I must have regard to the rules and guidance laid down in COBS20.2 of the FCA Handbook.

I can confirm that, in my opinion, the Board has generally acted in a manner consistent with the PPFM in the year from 1 April 2013 to 31 March 2014. There are items which require further work:

1) The Board needs to ensure the Branch complies with all the requirements of the FCA's policy statement PS12/4 'Protecting with-profits policyholders', especially with profits corporate governance and ensuring that continuing to write new business is not detrimental to existing with profit policyholders.

2) The Board needs to incorporate the individual policy asset shares within the surrender value methodology to ensure fair values are paid to all policyholders.

I can confirm that, in my opinion, the Board has taken the interests of with profit policyholders into account in a reasonable and proportionate manner and that the transfer to shareholders is consistent with reasonable expectations of policyholders.

S. W. Dixon BA, FIFA, FSAS

With Profits Actuary for the UK Branch of LICI