



## Report of the Board to with-profits policyholders

FSA Rules require the Directors of LIC 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 2008 to 31st March 2009, the financial year reckoned by LIC.

In April 2005 LIC 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 now.

In 2008-09, both the PPFM and its consumer friendly version were updated. The main change was the inclusion of wording which permits the Branch to apply a Market Value Reduction to ISA policies where this is justified by market conditions. This report follows the various sections in the PPFM.

### **Over-riding principles**

The Branch has four key financial objectives that have absolute priority. 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
- (d) Subject to (a), (b) and (c), to maximize 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**

The Branch determines payouts by reference to specimen asset share figures for representative ages and terms. These figures indicate that the current maturity payouts are in excess of the amount that the individual policies have earned. As far as possible, the branch has, therefore, continued its policy of reducing payouts on maturity to lower levels in order to be fair to the majority of policyholders whose policies are not maturing immediately by restricting the amount of over-distribution to current maturities.

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.

LICI is already in a situation where the guaranteed benefits exceeded asset share by a good margin and the negative return on the portfolio during the year due to market conditions further widened the gap between asset share and the payout. Such payouts cannot be reduced as they consist of the sum assured and the reversionary bonuses already declared which have vested in the policy. As such it is not likely that LIC can, during the year 2008-09, achieve the target of 90% of maturing policies receiving a payment of between 80% & 120% of asset share.

In the year ending 31 March 2009 the actuary submitted a report to the Board in February, 2008 recommending that changes should be made to the surrender value basis in order to ensure fair treatment of policyholders who surrender their policies. The Board did not agree with all the recommendations and instead decided to

- a) Allow paid up value and special surrender value for all policies where premiums have been paid for full two years.
- b) Revise Special Surrender Value factors for with-profit policies issued on or after 01.04.2003 and to retain the existing Special Surrender Value factor for policies where premiums have been paid for full two years.
- c) Allow final additional bonus in respect of with profit policies surrendered on or before 01.04.2009 with duration of 5 years or more based on paid up sum and duration in force.

### **Annual and final bonuses**

For the year ending 31st March 2009, keeping in view the investment climate annual bonuses have been reduced to 0.5%. These rates will be supported on achieving the targeted investment performance. Final bonus rates for all policies have been removed.

The asset share calculations, referred to above show that no policies near to maturity have earned any final bonus, because of the amount of annual bonus they have been granted in the past.

### **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-profit 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 the reduction in payouts was between 2.5% and 4.5% and the fall in asset share was up to 9 %. This, as explained earlier, was due to the higher annual bonus declared during earlier years.

No market value reduction was applied to the ISA contract during the year.

### **Investment policy**

The investment policy allows for about 30% of the fund to be invested in equities. From 1<sup>st</sup> April 2008 the investment management of the fund was entrusted to M/S Fortis Private Investment Management Ltd. The funds invested in Legal & General unit trusts were moved mostly to directly held assets though there are still a small percentage invested in unit trusts.

The switch over to M/S Fortis has proved beneficial to policyholders as the investment performance over the year has been in excess of the benchmark.

### **Business Risks**

The Branch is managing its business risks in a sensible manner. It is putting a high emphasis on increasing the amount of new business sold in order to try to ensure that overheads are spread over an increasing amount of business. 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 in the customary way.

### **Transfer to shareholders**

The Company's statutes state that 5% of the emerging surplus is to be allocated to the shareholder. In recent years this has meant 5% of the cost of annual bonus, and this amount shall be remitted to the shareholder out of the surplus for the financial year ending 31st March 2009.

### **Changes to the PPFM**

The PPFM was changed during the year to clarify the fact that a Market Value Reduction can be applied to an ISA contract if it is surrendered. The MVR can be applied at the firm's discretion if the value of investments underlying the policy has fallen below the face value of the policy.

### **Other issues**

New business in the financial year has shown some increase over the previous year though it is still far short of the desired level. The Branch is committed to increasing this in the current year

to ensure that the costs of writing new business can be spread across a sufficient volume to make it economical to write such business.

The with-profits actuary mentioned several issues for future attention in his report to the Board and the Board is ensuring that progress is made on these issues.

### **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.