



Report of the Board to With-Profits Policyholders 2010-11

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 2010 to 31st March 2011, 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.

There were no changes made to the PPFM or its consumer friendly version during the year.

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 policy holders 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 has already been in a situation since a number of years back where the guaranteed benefits exceeded asset share by a good margin as the guaranteed sum assured and declared reversionary bonuses vested in the policy were already higher and nothing could be done about it. The continued good fund performance during the year has reduced the gap to some extent but it is unlikely that LIC during the year 2010-11 has been able to achieve the target of 90% of maturing policies receiving a payment of between 80% & 120% of asset share.

In his report to the Board, the actuary has recommended refinement of the asset share calculation to ensure that they are able to identify the total assets backing policyholder liabilities in a more reliable way.

Board had approved changes to the surrender value basis of certain policies two years back based on the recommendation of the then actuary. The current actuary has recommended carrying out further work on revising the surrender value basis for the remaining policies.

The recommendations of the actuary are under consideration.

Annual and final bonuses

For the year ending 31st March 2011, keeping in view the investment climate annual bonuses have been kept at the same levels. These rates will be supported on

achieving the targeted investment performance. The policy of not allowing any terminal bonus has continued for the year.

The asset share calculations, referred to above show that no group of policies near to maturity has earned any terminal 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 LICl's investment returns have not fluctuated as much as those of other with-profit funds. LICl 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 2.6% and 4.8%. This, as explained earlier, was due to the higher annual bonus declared during earlier years. Asset share values were on average 0.96% lower.

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. BNP Paribas Private Investment Management is entrusted to manage the fund. The Board believes that the Fund Manager provides a satisfactory level of service.

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 2011.

Changes to the PPFM

There has been no change made to the PPFM during the year.

Other issues

Compared to the previous year new business premium in the financial year has shown good growth in spite of showing some decline in number of policies. This is the fourth consecutive year of growth in new business premium though it is still 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.

There has been an increase in management expenses, mainly attributable to higher new business commission, additional actuarial costs for additional jobs demanded by new regulatory requirements and higher fund management expenses linked to growth in fund value. Other management expenses were kept under control and showed marginal decline.

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.