



Life Insurance Corporation of India (UK Branch)

Principles and Practices of Financial Management

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# 1 Introduction

- 1.1 This document (known as the PPFM) sets out the Principles and Practices of Financial Management by which the UK Branch of the Life Insurance Corporation of India (“The Branch”) conducts its with-profits business. It has been approved by the Corporation’s Board of Management.
- 1.2 The document has been written to meet the standards required by the Financial Services Authority (FSA) according to the relevant rules and guidance as set out in their Conduct of Business sourcebook. Its purpose is to enable a better understanding of the way the Branch conducts its with-profits business and, in particular, the principles and practices adopted by the Board in the application of its discretion. This improved understanding is intended to protect the interests of and promote confidence among with-profits policyholders.
- 1.3 Principles are intended to be enduring statements of the overarching standards adopted by the Branch and are expected to change infrequently. Practices, on the other hand, describe the Branch’s current approach and will be subject to more frequent change but within the principles then applying. The format of this report considers each key area where discretion is applied and sets out firstly the relevant principles, followed by the practices.
- 1.4 In the event that the Branch determines that changes are required to any of the principles contained herein, procedures are in place to control such changes. These include the requirement to provide with-profits policyholders with at least three months prior notice in writing. Changes to practices, though they do not require prior notice, must also be communicated within a reasonable time period.
- 1.5 The Branch is required to have and has in place governance arrangements to ensure that the conduct of its with-profits business complies with this PPFM document. These include an annual report to with-profits policyholders from the Board and an independent assessment of compliance. (1)
- 1.6 The PPFM document is a complex technical document which may not be readily understood by policyholders. LICICI has also produced a document known as its Consumer Friendly Principles and Practices of Financial Management (CFPPFM). This sets out in simpler language the most important parts of this document. In the event of any disagreement, if any, between the two documents it is the full document which will prevail.
- 1.7 The document is available to all policyholders on request free of charge. It can be downloaded from the website [www.liciuk.com](http://www.liciuk.com) or supplied in paper form on request to the Branch Office. It is also available to non-policyholders, in which case a charge may be made for supplying a paper copy. The CFPPFM will be sent to all policyholders and can also be downloaded from the website.

## 2 General Principles

- 2.1 The Branch has four key financial objectives that can be regarded as overriding the principles and practices contained elsewhere herein if they come into conflict. 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 maximise the financial returns to with-profits policyholders and the shareholder.
- 2.2 The Life Insurance Corporation of India (LICI) is a company owned by the Government of India, and distributes a proportion of its surplus to the shareholder. The distribution is governed by the Life Insurance Corporation Act 1956. This states that where a surplus emerges “ninety five per cent of such surplus or such higher percentage thereof as the Central Government may approve shall be allocated to or reserved for the life insurance policyholders of the Corporation.”
- 2.3 The Branch has a single long-term business fund in which all business is transacted. All income and expenses of the long term business are allocated to the fund. Assets required to cover current liabilities and some surplus assets are held outside the fund but are all attributable to long term business.

### 3 Third Party Management Agreement

- 3.1 In April 2003 LICI entered into an agreement with Teachers Provident Society (TPS) for the provision of management services to the Branch. These services included administration, accounting, actuarial and investment services. These services terminated at 31 March 2008 and a new manager for the administration and other services has been appointed

## 4 The amount payable under a with-profits policy

### **Principles**

- 4.1 In assessing the amounts payable under a with-profits policy, the aims of the methods used are to meet the objectives as set out in 2.1. Importantly, they aim to provide policyholders with a fair return on their policy that reasonably reflects the experience of the fund whilst the policy has been in-force and subject to any smoothing.
- 4.2 Bonus is generally distributed by means of annual (also known as reversionary) bonus and final (also known as terminal) bonus. The amount payable under a with-profits policy is generally determined by reference to a guaranteed basic benefit, the attaching annual bonuses and the final bonus applicable at the date of claim. The exception to this is the with-profits ISA where the amount of the basic benefit is not guaranteed.
- 4.3 For a number of years the Branch has calculated asset shares to assist in determining the payout due on maturing policies.
- 4.4 The Branch will also conduct investigations and projections to establish the appropriate proportion of bonus and payout to be paid in final (non-guaranteed) form. The proportion is assessed having regard to the targeted free asset position, investment mix and the desired level of equity required between generations and classes of policyholders.
- 4.5 In applying the methods to determine the amounts payable under with-profits policies there is a need to consider historical experience and, where appropriate, make assumptions about the past.(2) In the light of new information, different methods or new techniques, the Branch may change any assumptions used regarding the historical experience. In making any changes the Branch will have due regard to the fair treatment of with-profits policyholders and the materiality of any change.

### **Practices**

#### General

- 4.6 The amount payable under a with-profits policy is generally determined by reference to a guaranteed basic benefit, the attaching annual bonuses and the final bonus applicable at the date of claim. For the with-profits ISA contract the amount of basic benefit is not guaranteed.

#### Asset Share Calculation

- 4.7 Bonus rates have, historically, been set without detailed consideration of the asset share of individual policies. Accurate data relating to investment returns and expenses from the point of sale onwards is not always available. Consequently, only specimen asset share calculations have been undertaken. These calculations have been made for quinquennial terms and specimen ages and are used as a guide to determine how much, if any, final bonus should be paid.

- 4.8 The asset share for an individual policy is calculated by taking into account the premiums paid, deducting the expenses incurred under the policy and rolling this amount up at the rate of interest earned on the assets. The calculation is based on an average size policy.
- 4.9 Allowance is made for the expenses incurred over the period, by expressing the new expenses in the year the policy was taken out as a percentage of annualised new business premiums and the renewal expenses for all subsequent years as a percentage of revenue premiums excluding new premiums. Some smoothing is applied to the expense percentages from year to year.
- 4.10 The specimen asset share calculations made up to 2001 assumed an investment return based on the investment income of the whole fund expressed as a percentage of the liabilities. The method has been amended to allow for an allocation of investment return to the free assets, and to allow for changes in capital values. This means that the investment return attributable to policyholders has been recalculated for all years back to 1990 and the asset share figures have been amended accordingly. Allowance is made in the calculations for the tax paid on investment return and tax relief received on expenses.
- 4.11 Credit is given for the actual mortality experience over the period. The cost of the actual mortality experience is charged to the asset share, so the asset share is increased where actual mortality experience is better than that assumed in the premium basis. No specific credit is given for profits arising from surrenders or other miscellaneous sources.
- 4.12 Up until 2004, no specific charge was made for the cost of capital or the guarantees given. From April 2005 the investment return used to calculate the asset share was reduced by 0.25% to fund the cost of guarantees and the cost of capital. This has become necessary as a result of increasingly stringent regulatory requirements.
- 4.13 No allocation of surplus arising from non-profit business is specifically made to policyholders. The amount of such business written before 2004 is trivial consisting only of term assurance riders to with profits policies and with-profits policies that have been made paid up. Profits from non-profit business written from 2004 onwards are funded by shareholders capital and will be allocated to the shareholder.(3)
- 4.14 The current asset share calculations indicate that for almost all First Series policies the sum assured and vested annual bonus exceeds the amount the policy has earned. This means that these policies will continue to receive a low annual bonus rate and only the longer term policies will receive any final bonus. The second series policies generally have more capacity to earn bonus than the first series. .
- 4.15 When considering the investment return the ISA business is assumed to be invested 50% in equities and 50% in fixed interest securities. Currently no other distinction is made between different classes of business (either with or non-profit).

#### Payouts on maturity

- 4.16 On maturity the Branch aims to pay an amount which is between 80% and 120% of asset share based on the relevant specimen policy calculations.
- 4.17 At present a number of policies have sum assured and bonus in excess of this amount and so will receive a percentage of asset share in excess of 120% but it is intended that bonuses will be kept at low levels until most payouts fall within the target range.

#### Payouts on surrender

- 4.18 On surrender the Branch aims to pay an amount which is between 75% and 115% of asset share based on the relevant specimen policy calculations.
- 4.19 At present the surrender value for some policies is in excess of this amount and so they may receive a percentage of asset share in excess of 115% if they surrender, but it is intended that bonuses will be kept at low levels until most payouts fall within the target range
- 4.20 The Branch will not pay a surrender value if the policy surrenders within two years of inception. In certain cases a paid-up policy may be granted.
- 4.21 If an ISA policy is surrendered or transferred to another provider at other than a date where a guarantee applies then a Market Value Reduction may be applied. This will happen if the market value of the assets in which the ISA is notionally invested has fallen below the face value of the units allocated to the ISA.

#### Other matters

- 4.22 The Branch has issued some unit-linked policies that are wholly reinsured with Axa SunLife. These policies were issued from 1992 to 2001. No new policies will be issued, but existing policies can be incremented. These policies have the option of investment in a with profits fund, however responsibility for the bonus declaration rests entirely with Axa SunLife and these policies are not covered by this document.
- 4.23 The business reinsured to Axa Sun Life currently gives rise to an additional tax charge. This is not specifically charged to the existing with-profits policyholders, although it does affect the amount of surplus emerging for distribution. Reinsurance commission received in respect of this business goes into the surplus.
- 4.24 The establishment of the third party management agreement with TPS in 2003 led to a substantial expense charge. This amount has been met by the shareholder who has provided additional capital for this purpose. The ongoing expenses of the administration will be included in the normal new business and renewal expense calculations and charged to asset share in the normal way. However for the new series with-profits policies the amounts charged to asset share will be limited to amounts which are consistent with the new business illustration provided to the customer.

4.25 The Actuary documents the methods, parameters and assumptions used to determine the amount payable to policyholders and key aspects are contained in reports presented to the Board. Changes can be initiated by either party and introduced subject to justification and approval by the Board.

## 5 Annual and Final Bonuses

### **Principles – annual bonuses**

- 5.1 The general aim in declaring annual bonuses is to provide with-profits policyholders with additional guarantees above the guaranteed basic benefits that increase over time. These guarantees apply to the policy at death or maturity but are not guaranteed in nominal terms on earlier termination.
- 5.2 The Branch may declare separate annual bonus series for different classes and generations of contract.
- 5.3 The starting point for the approach used is to consider the sustainability of bonus rates that do not depart significantly from those declared in recent years, having particular regard to the financial impact on the Branch in terms of its projected free asset position.
- 5.4 The Board aims to set annual bonus rates that do not fluctuate widely from declaration to declaration on a year to year basis, and to give policyholders a reasonable expectation that similar bonuses can be declared in future years. However, the bonus rates will change if our view of the future long term experience changes, with due regard to PRE (4) and recent bonus levels. Bonuses will only be declared if there is a surplus in the fund.

### **Practices – annual bonuses**

- 5.5 Annual bonus rates are declared at the discretion of the Board. Current practice is to set rates for conventional contracts annually in arrears. In the normal course of events the Board would not expect to re-set annual bonus between declarations. However, in the event of a significant change in economic circumstances that could adversely affect the surplus expected to be available for distribution, the Board can use its discretion to alter annual bonus rates at any time
- 5.6 The Branch currently has two annual bonus series for conventional with-profits policies. The First Series applies to all single premium with profits policies issued before April 2002 and all regular premium policies issued before February 2004. The Second Series applies to all other with-profits policies. Within each series the bonus declared for a particular policy may vary according to the exact type and term of that policy.
- 5.7 In addition the Branch has a with-profits ISA contract which has a different style of annual bonus. The ISA bonus rate is reviewed every six months and the rate is applied on a daily basis for the following six months.
- 5.8 As described above, the Board's aim is to set annual bonus rates that will change relatively infrequently and avoiding wide fluctuations. Nevertheless, the Board does not have any maximum amount by which annual bonus rates would alter. In a situation where solvency was under threat, or there is not expected to be sufficient surplus in the fund, the Board may act to reduce annual bonus rates significantly. Indeed, in extremis, it may decide not to declare a bonus.

- 5.9 The anticipated endowment policies, which are all First Series policies, have a separate bonus scale, but the principles of distribution of surplus are the same.
- 5.10 For the First Series historic bonus rates were set based on the investment income earned in the fund. During the 1990's bonus rates were reduced more slowly than the fall in interest rates warranted. Current bonus rates for this series reflect the move to a lower interest rate environment and the substantial guarantees given in the premium rates. This means that they are currently at low levels and are likely to remain so.
- 5.11 For the Second Series, which has a lower guaranteed interest rate than the First Series, the intention is that annual bonus rates should be no higher than the rate earned on the fixed interest investments of the fund, after allowing for guarantees implied in the premium rates and taking expenses into account. The declaration will also take account of current and expected future economic and demographic experience over the lifetime of the policy, and the investment policy. It will be set to include an appropriate margin for final bonus. The latter is important to permit greater investment freedom and establish equity between generations and classes of policyholders.
- 5.12 Annual bonuses for both First and Second Series policies are expressed as a percentage of the sum assured. This is usually referred to as a "simple" bonus system.
- 5.13 The with-profits ISA operates on a compound bonus system. In this case the bonus is declared as a percentage of the accumulated fund. This bonus rate is also set in a different manner. The ISA has no "sum assured" and the fund is the accumulation of premiums to date plus the bonus rate net of the fund management charge.
- 5.14 The ISA is deemed to be invested 50% in fixed interest securities and 50% in equities. The bonus rate is set by considering the yield available on fixed interest securities and reducing this by the management charge of 1.5% and a prudent margin. The fund's performance is measured using a shadow portfolio and to the extent that the performance of the shadow portfolio exceeds the annual bonus granted, a final bonus will normally be payable once the contract has been in force for three or more years. However if the policy is surrendered at a time when the value of the shadow portfolio is less than the face value of the units allocated (including vested annual bonus) then a Market Value Reduction may be applied.
- 5.15 If a with-profits policy is made paid up before the end of its contractual term the annual bonus added to date is credited to the policy, but the policy then becomes non-profit and receives no further bonus additions.
- 5.16 Where circumstances change to such an extent that it would be unfair to existing or new business policyholders to share the same rates of bonus, The Board may, on the advice of the Actuary, decide to declare an alternative bonus series, amend the basis of the contract or withdraw the type of policy altogether.
- 5.17 The Branch has on its books a very small number of policies which were acquired from other companies when the Indian Government nationalised the industry in 1956.

Such policies receive a bonus which is a pre-defined percentage of the main declaration. The percentage is shown in the following table.

| <b>Issuer</b>  | <b>Percentage of Standard Rate</b> |
|--|------------------------------------|
| All India and Burma Provident Fund   | 140%                               |
| Gresham Life Assurance Society<br>Norwich Union Life Insurance Society   | 130%                               |
| Aryan Champion Insurance Company<br>Indian Mercantile Insurance Company<br>Oriental Government Security Life Assurance Company<br>Prudential Assurance Company   | 120%                               |
| Asian Assurance Company<br>Bombay Life Assurance Company<br>Bombay Mutual Life Assurance Society<br>Industrial & Prudential Assurance Company<br>New Asiatic Insurance Company<br>New Great Insurance Company of India<br>New India Assurance Company<br>Universal Fire & General Insurance Company<br>Jupiter General Insurance Company (all policies)  | 110%                               |
| General Assurance Society<br>Hindustan Co-operative Insurance Society<br>Lakshmi Insurance Company<br>Life Insurance Corporation of India<br>(Including policies issued after 19.01.1956 by Insurers other than Jupiter General Insurance Company, Mysore Government Insurance Department and Patiala Insurance Corporation)<br>National Insurance Company<br>Asiatic Government Security Life & General Assurance Company<br>Prithvi Insurance Company<br>Indian Life Assurance Company | 100%                               |

- 5.18 Bonuses are allotted to all conventional participating policies in force for the full Sum Assured on 31st March in each year. For those policies issued by the insurers whose business has vested in the Corporation (see table above), the entitlement to annual bonus includes policies which have been made paid-up for a reduced Sum Assured. (5)
- 5.19 The ISA bonus accumulates on a daily basis, so a policy that has been in force for six months will have accrued half a year's bonus.
- 5.20 With-profits policies which become claims by death or maturity or which are surrendered prior to the bonus declaration for the year are entitled to an interim annual bonus at the same rates as applied at the previous declaration date. In the case of

surrenders only a proportionate bonus will be allowed in respect of the policy year current on such date unless all instalments of premiums for the policy year have been paid before the date of surrender.

### **Principles – final bonus**

- 5.21 In determining the total payout on a policy becoming a claim the Branch may add a final bonus aimed at increasing the benefits guaranteed under a policy to the underlying value of that policy as assessed by the experience throughout its lifetime within the fund.
- 5.22 The Branch may declare separate final bonus series for different classes and generations of contract.

### **Practices – final bonus**

- 5.23 Final bonus for both First and Second Series policies are expressed as a percentage of the sum assured. This is usually referred to as a “simple” bonus system. Final bonus for ISA policies will be expressed as a percentage of the accumulated fund.
- 5.24 Final bonus rates are declared at the discretion of the Board on the advice of the Actuary. The levels of final bonus rates are reviewed at regular intervals, not less frequently than annually, but more frequently when significant changes in investment market dictate.
- 5.25 Any final bonus is generally only paid on claims where the policy has been in force for a minimum number of years varying by type.
- 5.26 Separate scales of final bonus apply to First Series policies expressed in sterling and rupees. A separate final bonus scale applies to Anticipated Endowment policies.
- 5.27 A separate scale will be determined for Second Series policies.
- 5.28 A separate scale will apply to ISA’s.
- 5.29 With-profits policies which become claims prior to the bonus declaration for the year are entitled to an interim final bonus at the same rates as applied at the previous declaration date.
- 5.30 Where a convertible Whole Life policy or a without profit policy is converted to a with profit policy, the qualifying period for Terminal Bonus will be reckoned from the date of policy anniversary from which it is entitled to participate in profits.
- 5.31 Under Children's Deferred Assurance Policies duration at claim will be reckoned only from the deferred date (vesting date). (6)

## 6 Smoothing

### **Principles – smoothing**

- 6.1 In framing a bonus declaration the Actuary compares the payout on a maturity claim with that for a similar policy maturing in the previous year to ensure it is not inconsistent.
- 6.2 The smoothing policy of the Branch takes due regard to factors such as the bonus policy, level of free assets, the investment mix and the policyholders' reasonable expectation. The General Principles 2.1(b) and (c) are of vital importance in this regard.
- 6.3 The total cost (and hence scale) of smoothing must inevitably be subject to the availability of adequate resources and cannot be allowed to grow too large in relation to the size of the long term business fund. The aim would however be to target a zero cost of smoothing over a reasonable period of time.

### **Practices – smoothing**

- 6.4 No formal smoothing practice exists as of now. The current smoothing methodology does not differentiate between generations and types of with-profits policies.
- 6.5 The current approach to smoothing is to limit the change in amounts payable under a with-profits policy to 10% from one declaration to the next in normal circumstances. However, as described in the practices governing annual and final bonus rates setting, the Board can, on the advice of the Actuary, depart from this 10% limit (or make declarations more frequent than annually) should the financial condition of the fund so dictate. The cost of smoothing would be a constraint on the smoothing policy; such cost should be reasonable in relation to the office's resources.
- 6.6 Claim payouts on surrender will receive any entitlement they may have to final bonus depending on duration in force. (7) The formula applied to surrender values and paid up values reflects economic conditions and can be changed by the Board on actuarial advice. However any such change will be constrained by the need for surrender payouts to fall within the target ranges given above.
- 6.7 For the ISA contract the annual bonus rate is set on a smoothed basis and final bonuses will apply according to the year the policy was taken out,

## 7 Investment Strategy

### Principles

- 7.1 The Branch's investment strategy supports the key financial objectives set out in Section 2. It is currently based on the view that while the security of the investment is paramount, there are advantages in investing a proportion of the portfolio in equities and property as these can be expected over the longer term to produce a better investment return than can be achieved by investing solely in cash and bonds.
- 7.2 The strategy, therefore, is to invest a high proportion of the funds in fixed interest investments but to invest the balance in equities and property with the aim of improving the investment return available to with-profits policyholders subject to an acceptable degree of risk. This spread applies by both asset class and individual holding, within the admissibility limits set by the FSA.
- 7.3 The asset classes that the Branch will consider are UK and overseas equities, fixed interest investments (such as gilts and other bonds) and cash.
- 7.4 In setting investment strategy, the Branch has regard to the nature and term of its long-term business liabilities, the extent of any guarantees applying and the need to demonstrate solvency. In theory, guaranteed benefits should be backed by fixed interest assets of the appropriate term and security but investment strategy can vary from this to the extent that free assets allow the Branch to support the resulting resilience reserve. Regard is also paid to the expectations of policyholders in relation to the nature of the assets backing their policies.
- 7.5 In determining the investment strategy and extent of deviation away from the theoretical matched position, the Branch can rely upon any long-term business assets, including those held outside the long-term fund and no distinction is drawn between with-profits and non-profit liabilities.
- 7.6 There are no constraints that apply with respect to parts of the fund either on account of separate policy classes or generations of business.

### Practices

- 7.7 The Branch outsources its investment management.. An Investment Management Committee is responsible for maintaining a sound system of control over the investment risk in all its forms. The Investment Management Committee meets quarterly.
- 7.8 The investment management agreement includes objectives, guidelines and constraints. Monthly and Quarterly reports are provided for review purposes. A formal investment review is currently carried out at least annually.

The Branch has a relatively conservative investment policy with the emphasis on maintaining the security of the funds through investment in fixed interest securities.

Current investment guidelines mean that at least 60% of the fund is invested in such securities. The current asset mix is available as an Appendix to this document.

- 7.9 For the purposes of the approach to investment, the long-term business fund can currently be considered as a single entity incorporating all the assets and liabilities of the Branch.
- 7.10 The fund does not invest in derivatives.
- 7.11 Any proposal to invest in a new or novel investment instrument would require approval by the Board based on a recommendation from the Investment Management Committee who in turn would seek advice from the Actuary.
- 7.12 The Branch's only holding of an asset that would not normally be traded is limited to a small (less than 2.5% of funds) property portfolio. This comprises houses purchased by LICI for the accommodation of senior staff while on secondment to the UK branch. The scale of this investment is not material in determining claim values and imposes no practical constraint on investment freedom.

## 8 Business Risk

### **Principles**

- 8.1 Business risks for the long-term business fund will include the acquisition and maintenance of with-profits and non-profit business. New business arrangements are covered in Section 11.
- 8.2 Any new venture involving significant resource or risk will be subject to a full cost benefit justification and risk assessment. It will require approval from the Board in India.
- 8.3 In general, any business risks outside the routine risks of effecting and carrying out insurance contracts would be supported by shareholder capital, and profits or losses arising would be borne by the shareholder and not attributed to with profits policyholders.
- 8.4 The assets attributable to the UK long-term business are maintained and managed in the UK.

### **Practices**

- 8.5 The initial costs of the third party management agreement with TPS in 2003 were met by an injection of extra capital from India. However there is a risk that future expenses under the new arrangement will be higher than at present resulting in less surplus available for distribution. This could happen for example, if the business volume stays lower than projected and as a result the per policy costs are higher than expected. The LIC Board has undertaken that excess costs of this nature will be borne by the estate rather than by the individual policyholder.
- 8.6 The Branch does not operate formal limits on the taking on of business risk.
- 8.7 The capital for writing non-profit business is provided by the shareholder and profits from this business accrue to the shareholder.
- 8.8 Any new venture involving significant resource or risk which had an impact on the relationship with the third party administrator would need to be agreed by the Branch Management Committee and a representative of the third party administrator.
- 8.9 There is currently no exposure to risks from other investments in subsidiary or associated operations.
- 8.10 The successful continuation of the outsourcing arrangement is a significant source of risk for the With Profit policyholders. The Branch has the right to inspect the provision of services under the agreement to ensure that such services are being provided in a satisfactory manner. In the event of its termination, the responsibility of each party to the arrangement is laid down in the agreement.

## 9 Charges and Expenses

### Principles

- 9.1 The aim of the Branch's approach to apportioning expenses to with-profits policies is that it should be fair and appropriate.
- 9.2 The basis upon which expenses are apportioned seeks to reflect the drivers and the activities that give rise to such expenses.

### Practices

- 9.3 The Branch's expenses are wholly attributable to the management of the long-term business operations. Expenses cover the acquisition of business (including commission) and the maintenance of business that includes administration and investment management as well as other structure costs. Costs are split between acquisition and maintenance. The basis on which expenses are apportioned reflects the drivers and the activities that give rise to such expenses. Bases (Basis ?) used include those based on time analysis, numbers of policies, percentage of premium, mean fund size or, indeed, a factoring up of direct costs. The apportionment bases (basis) used from time to time have regard to ease of application and consistency as well as fairness.
- 9.4 The acquisition and renewal expense ratios which are derived are applied to both non profit and with-profits business.
- 9.5 Any expenses included and apportionment basis adopted must be appropriate for the purpose and compliant with any relevant rules and guidance. In general all costs will be included and apportioned but circumstances can arise where adjustments may be appropriate, for example, in determining the amounts payable under with-profits policies. By way of example, adjustments may be made to allow for the amortisation of significant development costs, non-recurrent expenditure and (providing it is of sufficient size) subsidy by the estate.
- 9.6 A basis change might be introduced to reflect changes to these drivers or activities (e.g. new outsourcing arrangements). It might also be introduced to accommodate new business methods and practices (e.g. new distribution). It may simply be introduced to improve the current apportionment basis in the light of new information.
- 9.7 An expense analysis is performed at regular intervals (at least annually) and this will include a review of any apportionment methods and bases (basis) adopted to ensure they remain appropriate over time.
- 9.8 There are no current circumstances under which the Branch will charge expenses at an amount other than cost.
- 9.9 The third party management company makes specific charges for the setting up of new business and the administration of existing business, and these charges are allocated to new and renewing policies accordingly.

- 9.10 The charges for fund management made for investment management are deducted from the investment income before it is allocated.
- 9.11 The costs of other external services will be allocated based on an assessment of relative amounts of time spent.
- 9.12 Apart from a split between new and renewal, expenses will be apportioned; using the methods outlined above, between with-profits and non profit policies so that the surplus emerging from non profit business can be determined separately.
- 9.13 Changes to the charges made as a result of the third party administration agreement will be approved by the Branch Management Committee.

## 10 Management of the Inherited Estate

### Principles

- 10.1 The term “inherited estate” is normally used to refer to surplus which has accumulated over the years and is not attributable to the current generation of policyholders.
- 10.2 The term “free assets” includes the inherited estate, if any, plus shareholders capital and any surplus attributable to the current generation of policyholders which will be distributed in the form of a final bonus on exit. It is generally defined as the excess of the total assets over the statutory liabilities (including the required capital margins).
- 10.3 The free asset ratio is determined by expressing the free assets as a percentage of total assets. The Branch does not have an explicit target in terms of the size of its free assets.
- 10.4 There are no constraints on the Branch’s freedom to manage the inherited estate as a result of previous dealings.

### Practices

- 10.5 The aim of the Branch is for the free asset ratio to fall in the range of 5% to 25% of total assets, although short and medium term economic pressures may militate against this
- 10.6 The Branch has no “inherited estate” as defined in 10.1, as over time all available surplus has been distributed to policyholders. The current free assets arise as a result of transfers of capital from the Head Office in India, investment return on that capital, surplus attributable to existing policyholders which has not yet been distributed and miscellaneous profits which are attributable to the shareholder.
- 10.7 The Branch intends to keep its capital intact and to build up the estate by virtue of interest earned on the free assets and by making a charge to asset share for the capital support that policyholders have enjoyed during their membership of the fund. Miscellaneous profits arising on non-contractual exits, which have not been distributed to policyholders, will also continue to build up the free assets.
- 10.8 In addition, by holding back some of the emerging surplus to be paid as final bonus when a policy becomes a claim, the Branch is building up some free policyholder reserves as part of the free assets, on top of the existing shareholder capital.
- 10.9 A free asset ratio of the size indicated above would give the Branch freedom to manage its business in the best interests of policyholders and other stakeholders. For example, it enables the investment strategy as set out in Section 7 to be pursued with the prospect of higher investment returns. It can enable higher levels of new business to be written which can help contain or reduce unit costs. It can enable greater smoothing in terms of payouts and reduce the immediate impact of financial shocks due to economic change or business risk.

- 10.10 The free assets are not a separately identifiable part of the fund and are available to meet all costs associated with the long-term business operations. No explicit allowance is made for the free assets in determining the amounts payable under with-profits policies.
- 10.11 The investment strategy for the free assets is the same as the strategy for the rest of the long-term business fund.
- 10.12 In general the assets backing with profits policies would not be expected to be applied to fund major business risks. Such risks would normally be funded by the free assets or by a further injection of capital from the shareholder and would be subject to robust risk analysis before implementation.
- 10.13 Where the free asset ratio falls outside the range referred to in 10.5, the aim would be to restore the position to within this range over a maximum 5 year timeframe provided this did not lead to the material unfair treatment of policyholders. The Branch undertakes regular investigations into the projected statutory solvency position under a range of scenarios using results of dynamic solvency testing as contained in the Financial Condition Report. The results and conclusions from these investigations are used to decide upon appropriate actions to manage the scale of the free asset ratio over time.
- 10.14 The business reinsured to Axa Sun Life currently gives rise to an additional tax charge. This is not specifically charged to the existing with-profits policyholders and is effectively met from the free assets. Reinsurance commission arising from this arrangement falls into surplus.

# 11 Management of new business

## **Principles**

- 11.1 The primary consideration in the setting of new business volumes is the level of resource (both in terms of capital and processing capacity) required. The Financial Condition Report (and projections contained therein) is used to establish any maxima in terms of limitations of the Branch's financial capacity to take-on new business where this becomes an issue. This would have regard to business mix if appropriate.
- 11.2 Consideration would also be given to the nature of the products being sold, their potential suitability for customers, the financial and business risks associated with the products and the methods and terms upon which they are sold as compared with the market.
- 11.3 Should the Branch determine that it is not in the interests of with-profits policyholders to remain open to new business; it will develop a closure plan. This will include a strategy for managing the closed book of business and how any inherited estate will be distributed over the expected lifetime of the with-profits policies.

## **Practices**

- 11.4 There are no specific practices regarding the setting of new business volume limits beyond those implied by the principles set out previously. Currently maximum volumes and business mix are not an issue.
- 11.5 The Branch has set no minimum scale in terms of new business volumes to justify staying open to new business. However, the position is subject to review from time to time according to the principles set out previously. The likely progression of unit costs and investment freedom under alternative scenarios would be key factors in any decision taken.

## 12 Allocation of profits

### **Principles**

- 12.1 The Life Insurance Corporation of India is 100% owned by the Government of India (the shareholder).
- 12.2 The division of profits between policyholders and the shareholder is governed by the Articles of Association of the Life Insurance Corporation of India.
- 12.3 The current articles allow for 5% of the emerging surplus to be remitted to India for the benefit of the shareholder.
- 12.4 The only circumstance in which this will change is if the Indian Government decides to amend the Life Insurance Corporation Act, 1956 ..

### **Practices**

- 12.5 The current practice is that 5% of the surplus emerging from the valuation of the conventional business is remitted to India for the benefit of the shareholder. Following long-established practice the share of surplus is calculated on the assumptions used for the valuation of the with-profits liabilities.
- 12.6 In addition a remittance based on revenue premiums is made to India to allow for the Head Office expenses incurred in running the Branch. This remittance is 0.5% of single premiums, 5% of new regular premiums and 1% of renewal premiums.
- 12.7 Policyholders have no specific rights to surplus emerging from sources other than with profits business.
- 12.8 The capital for writing non-profit business has been provided by the shareholder and profits emerging from new non-profit business will, for the present, be retained in the long term business fund to help build up the shareholder's capital. There is no intention that it will be included in the surplus available for distribution to with-profits policyholders.
- 12.9 The Branch operates a single long term business fund and the surplus emerging from non-profit business will be determined as the cash flows attributable to that business including an appropriate allocation of expenses and investment income.

## 13 Glossary

|                      |   |
|----------------------|---|
| The Actuary          | The With-profits actuary of the Branch  |
| The Board            | The Board of the Life Insurance Corporation of India  |
| The Branch           | The UK Branch of the Life Insurance Corporation of India  |
| Compound Bonus       | A bonus expressed as a percentage of the policy sum assured and vested bonus to date                      |
| First Series policy  | A single premium policy issued before April 2002 or a regular premium policy issued before February 2004. |
| ISA                  | An Individual Savings Account policy.   |
| LICI                 | The Life Insurance Corporation of India   |
| Second Series policy | A single premium policy issued after March 2002 or a regular premium policy issued after January 2004.    |
| Simple Bonus         | A bonus expressed as a percentage of the policy sum assured   |

# Appendix 1 Current Investment Benchmarks

| <b>Asset class</b>        | <b>Benchmark %</b> | <b>Permitted range</b> |
|---------------------------|--------------------|------------------------|
| UK Equity                 | 26.0%              | 21% - 31%              |
| Overseas Equity           | 4.0%               | 0% - 8%                |
| Fixed Interest Securities | 65.0%              | 60% - 70%              |
| Cash                      | 5.0%               | 0% - 10%               |
| Total                     | 100.0%             |                        |

We would like to make you aware that calls may be recorded and monitored.  
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