

Report of Board to With-profit policyholders 2008.

Report of the board to with-profit policyholders

FSA requires the Directors of LIC to report to the with-profits policy holders of its UK Branch how their interests are looked after during the year. This report covers the period 1 April 2007 to 31 March 2008 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 firm intends to manage its with-profit business and how it ensures that its customers are treated fairly. A consumer-friendly version of the PPFM is available. During 2005-06 the PPFM was changed to bring it in line with FSA rules. The revised document took effect from 31 December 2005.

During the reporting period a revised version of the PPFM took effect which is described in this report.

The 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 policy holders
- (b) To meet the tests of solvency and capital adequacy as required by the regulatory bodies
- (c) To treat policyholders fairly and meet the reasonable expectations of the with-profits policyholders
- (d) Subject to (a), (b) and (c), to maximize the financial returns to with-profit 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 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. The branch has, therefore, continued its policy of reducing payouts

on maturity to lower levels in order to be fair to the majority of the policyholders whose policies are not maturing immediately by restricting the amount of over-distribution to current maturities.

Target ranges for payouts came into effect from 1 January 2006. The specimen asset share indicates that for maturing policies payments made during the period have generally been in excess of asset share, some exceeding the top of the target range and that is consistent with the practices followed by LIC. Such payments cannot be reduced as they consist of the sum assured and reversionary bonuses already declared which have vested in the policy.

A proposal for a new surrender value basis applying to all with-profit policies is under consideration. The proposal is to bring all the with-profit policyholders to be treated fairly.

Annual and Final Bonuses

The annual bonus rates for the year ending 31 March 2008 are maintained at the same rates which were declared for the previous year. In a poor year for investment markets the rates earned on the funds were sufficient to support the bonus rates. Final bonus rates for policies are also maintained as those in the previous year.

Smoothing

The UK Branch aims to smooth the fluctuations of investment returns and other sources of surplus over the period of the contract. The main plank of the smoothing policy is to restrict the amount by which a claim value can change on identical policies maturing in consecutive years.

The bonuses remained the same over the last few years. However the payouts on maturity were between 2% and 5% lower. This is due to the higher annual reversionary bonuses declared during earlier years

The maximum reduction in claim value was 5% and in general the payouts were consistent with the reduction in asset shares. Although the payouts were in excess of the asset share, the amount of overpayment has reduced slightly. The reduction in asset share of specimen policies were 1% or 2% less than the reduction in payout. As the payouts were all in excess of asset share the amount of overpayment has reduced slightly.

Investment strategy

The with-profit funds were invested with the Legal and General Investment Managers (LGIM) during the period. The Board, in August 2007 has made changes to the investment policy to allow for investments in equity to 30% from earlier 18% of the invested funds.

The with-profit funds are now managed by Fortis Private Investment Managers (FPIM) with effect from 1 April 2008.

Business Risk

The change in the outsourced Third Party Management Services has been effected from 1 April 2008. The Management Services are now provided by Wapeka Limited replacing the services provided by Teachers provident Society (TPS) till 31 March 2008.

The costs are higher than those under the previous agreement but not high as they would have been on continuing the services with TPS.

The switch to Wapeka from TPS is believed not to have any adverse impact on the ability of LICU to continue to treat its customers fairly. The risks associated with the outsourced Management Services are recognized by the Board and an independent system audit is proposed to be carried out to ensure robust systems and controls ensuring compliance with regulatory rules.

Charges and expenses

The allocation basis used allocates an appropriate share of expenses to with-profit policy holders. The existing illustration basis is retained and the expenses charged for asset share for a new series policy would be limited to those used in the illustration basis. The normal expenses of running the business have been charged to policyholder asset share in the customary way.

Management of the Estate

The free assets as at the end of March 2008 amounted to £8.8 million which is 16% of the long term business assets. This represents shareholders capital and also the undistributed policyholder surplus to be distributed as bonus.

Management of New Business.

New business in the financial year continued to be disappointing and the branch is committed to increasing the new business in the current year to ensure that the costs can be spread across a sufficient volume to make it viable to write such business.

Allocation of profits

The Branch's Article state that 5% of the cost of annual bonus on the valuation basis out of the surplus is to be allocated to shareholder. This is consistent with the practices and remains well within the limits of 10% stated in COB 6.12.56.

Changes to the PPFM

Revised version of PPFM took effect from early 2008. No material changes were made to the principles but changes were made to the practices and the most important ones are listed below:

1. The wording changed to allow for the change of Third Party Manager.

2. Clarification of some aspects of asset share calculation.
3. Specific reference to the investment mix attributable to with-profit ISA's.
4. Amplification of how the ISA bonus rate is calculated and applied.
5. Changes to the investment management practices to allow for higher equity backing ratio.
6. The charges to asset share to reflect the limits on the charge to with-profits asset share.
7. Amendment in the definition of asset share to describe the relative components more fully.

Other issues

The Actuarial function holder mentioned several issues for future attention in his report to the Board and the Board is ensuring that progress is made on these issues. The issues in the main are the high costs of running the business and to write new business in sufficient volumes. The concern is to increase the size of the overall portfolio so as to absorb the high costs of running the business and make the business viable.

Summary

Having reviewed the year under question, the Directors are pleased to report to the With-profit policyholders that the affairs of the UK 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

I have made a report to the Board in accordance with the requirements of the Supervision Manual to inform them of my view of the way in which the PPFM has been applied and how discretion has been exercised in respect of the with-profits policyholders.

I am also required by the Supervision Manual to draft a report to with-profits policyholders to accompany the firm's annual report required by COBS 20.4.7R, 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-profits policyholders into account in a reasonable and proportionate manner. In doing this I must have regard to the rules and guidance in COBS 20.2

I can confirm that, in my opinion the Board has acted in a manner consistent with its PPFM in the year from 1 April 2007 to 31 March 2008.

I can also confirm that, in my opinion, it has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner.



David Lechmere FIA
With-profits actuary for LIC(UK)