

How we manage our with-profits business – a guide

This document gives information about the with-profits policies issued by the UK Branch of the Life Insurance Corporation of India (LICI UK). It is intended to help you understand how LICI UK will manage the with-profits fund in which your policy is invested and how bonuses are calculated. It also describes various matters which affect the with-profits fund and lets you know how LICI UK deals with them.

This document is known as the “Consumer-Friendly Principles and Practices of Financial Management (CFPPFM for short). It is an extract of the most important information from LICI UK’s full Principles and Practices of Financial Management (PPFM) in a form which we hope you will find easier to understand.

You may want to refer to the PPFM for a fuller description of the way LICI UK manages its with-profits business, copies of which are available on request. If there are any disagreements between this document and the full PPFM then it is the version in the full PPFM which will apply.

This document uses a number of special terms. These are defined within the document. To help you know which these are they are shown in bold italics (for example ***asset share***)

Who or what is LICI?

LICI is the Life Insurance Corporation of India. It is an insurance company which is 100% owned by the Government of India (referred to in this document as “the shareholder”). LICI operates in the UK through a Branch which is referred to in this document as LICI UK.

Which policies does this document cover?

It covers all with-profits policies issued by LICI UK, including any policies acquired at the time of nationalisation of the Indian insurance industry in 1956 and the with-profits ISA policy. The only policies it does not apply to are the unit-linked policies which are wholly reinsured with Axa-SunLife. These are covered by the relevant Axa-SunLife CFPPFM.

How will LICI manage my money?

There are four key financial principles that LICI UK will observe:

1. To pay policyholders their guaranteed benefits
2. To maintain sufficient funds to allow it to remain in business
3. To treat its policyholders fairly
4. Subject to 1, 2 and 3 to invest its money to provide the best possible rate of investment return for the with-profits policyholders and the shareholder.

How does LIC I UK decide what benefits I should receive?

Every conventional with-profits policy issued by LIC I UK has a guaranteed sum assured. This is fixed at the time the policy is issued and will not be reduced as long as you continue to pay the agreed level of premiums. The only exception to this is the with-profits ISA contract which has no guaranteed minimum amount.

In addition LIC I UK will add bonuses to this sum assured. There are two types of bonus, annual and final.

Annual bonuses are calculated each year as a percentage of the sum assured. Once an annual bonus has been added to the policy it becomes part of the basic policy benefit and cannot be taken away. It may however be reduced if the policy is made paid-up or surrendered.

Final bonuses are also calculated each year. They apply only to claims by death or maturity (not to surrender claims).

There are two 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. Annual and Final bonuses are different for the two different series. In addition the Anticipated Endowment policies (all First Series) have historically had separate bonus rates and Single Premium policies also now have a separate annual bonus rate.

How is my annual bonus worked out?

The bonus rate is set annually by the Board of Directors of LIC I (the Board). The rate is set by looking at the experience of the fund over the year. The most important factor is the amount of investment income earned. Rates are normally set once a year, but the Board has the right to alter the annual bonus rate at any time should this be necessary.

The bonus is declared as a percentage of the original sum assured under the policy. This is known as a Simple Bonus. The one exception to this is the new with-profits ISA contract. These contracts do not have an initial sum assured and the bonus will be declared as a percentage of the accumulated fund.

First Series policies have a relatively high guaranteed sum assured. The rate of interest LIC I UK is earning on its investments is sufficient to support this guarantee but not sufficient to allow for much in the way of bonus. This is the reason why bonus rates have reduced over the last few years. It can be expected that they will remain very low unless there is a significant upward movement in interest rates.

Second Series policies have a lower level of guarantees and can expect higher annual bonus rates than First Series policies.

If a policy is made paid-up (in other words if you stop paying premiums) then the annual bonus added to date is credited to that policy, but the policy will receive no further bonus additions.

How is my final bonus worked out?

The final bonus is calculated by reference to the *asset share* (see below). *Asset shares* are calculated for specimen policies (based on an average age and the most popular policy terms (10, 15, 20 and 25 years). If the *asset share* exceeds the total of the sum assured and annual bonus declared to date then a final bonus may be payable. Such a bonus will be calculated and added to the sum assured and existing bonus to bring the total payout up to the *asset share*.

It is important to realise that this is not an exact calculation and is only done for specimen policies, so, for example a single rate of bonus will apply to all 25-year policies maturing in a given year. This is called “*smoothing*” and is explained further below.

Final bonuses are also declared as a percentage of the original policy sum assured.

What is an *asset share*?

In various places in this document the term “*asset share*” is used. The *asset share* for a policy is calculated by taking the premiums paid year by year, deducting the expenses of selling and administering the policy, and increasing the value by the interest earned on the fund from year to year.

In the case of LICI UK an adjustment is made to the *asset share* for mortality and expense profits. This means that if LICI UK pays out less on death claims than expected then the extra money it has in hand will be shared out among the existing with-profits policyholders. It also means that if the firm spends more on expenses than it had hoped then the costs will be shared out among the with-profits policyholders. From 2005 LICI will reduce the assumed investment return used to calculate asset shares by 0.25%. This deduction is to allow for the guarantees given on the policies and the cost of the capital needed to support them in the early years.

Profits from surrenders and other miscellaneous sources of surplus are not directly taken into account in the *asset share* calculation. Such profits go to build up the *free assets* (see below). Also profits from the new series of non profit contracts will not be allocated to with-profits policyholders as the capital to fund these has been provided entirely by the shareholder.

The *asset share* of a policy does not dictate the amount of money a policy will receive when it becomes a claim. However it does inform the decisions that are made with regard to the right amount of bonus to declare each year.

What is *smoothing*?

Smoothing is a process which applies to with-profits policies to ensure that the amounts paid out do not vary wildly from year to year. Unlike a unit-linked policy where the value goes up and down daily in line with a particular fund the value of a with-profits policy can never fall below the value of the sum assured and bonus already allocated to it.

LICI UK’s current approach to *smoothing* is to ensure that the amount paid out on a claim on a particular policy will not vary by more than 10% from year to year. In practice the main way to vary the claim amount is by changing the final bonus and at present the final bonus amount is small in relation to the amount of sum assured and annual bonus. This means that the total payout will not vary by as much as this.

LICI UK will aim to smooth bonuses and payouts so that for maturing policies the payout is between 80% and 100% of the asset share. For policies which surrender the aim is that the payout will be between 75% and 115% of asset share.

Smoothing also means that a single rate of bonus applies to all policies of a certain term or duration in force. This means that larger policies receive the same bonus rate as smaller ones.

Can benefits be reduced?

For most contracts the sum assured cannot be reduced and annual bonuses, once added will not be removed. For the with-profits ISA contract LICI may impose a Market Value Reduction (MVR) if the policy is surrendered. This will only apply in the situation where the market value of assets has fallen and the face value of the policy is in excess of the value of the underlying assets. The amount of the MVR will be calculated by the company’s actuary. An MVR will not be applied if the policy is cashed in on its tenth anniversary, nor will it apply to a benefit paid on death.

How is my money invested?

The money you pay in premiums is invested by LICI UK in a range of different assets. These include government securities, other fixed interest securities and equity shares (of UK and overseas companies).

LICI UK adopts a relatively cautious attitude to investment with a high proportion of the fund invested in government securities. However the proportion invested in equities has increased over the last few years as in the long term these should produce a better return on the invested funds.

Guidelines for the proportion of assets to be invested in each class of asset are agreed between LICI management and the investment manager. These guidelines are reviewed at least once a year. The current investment guidelines are as follows

Asset class	Benchmark %	Permitted range
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%	

LICI UK also holds a small amount of property in its funds. Originally, this comprised houses purchased by LICI for the accommodation of senior staff while on secondment to the UK branch. All of them barring one are currently used as investment properties and rented out.

How are the expenses of the policy covered?

The premiums you pay for your with-profits policy include an allowance for the expenses of selling and administering that policy. The only exception to this is the with-profits ISA contract which is described separately further on in this section.

All LICI UK's policies, both with and without-profits are administered in a single fund, and all the expenses of the Branch are charged to that fund. These expenses include all the expenses of acquiring new business and the expenses of keeping that business in force, including, for example, costs of administration, investment management and regulatory fees. LICI UK splits the costs between acquisition and maintenance in different ways according to the particular costs. The split may be based on an allocation of time, on the number of policies, the size of the premium or some other appropriate measure.

These costs are deducted from the fund in which the money is invested. They are also taken into account in the calculation of *asset shares*.

Certain exceptional expenses (for example setting up a new administration system) may be treated separately from "normal" expenses and will not be charged directly to *asset shares* but will be charged to the *free assets* (see below).

For the with-profits ISA contract the charges for expenses are deducted from the build up of the fund by reducing the bonus rate allocated to the contract. So for example if it was decided that the policies had earned a bonus of 3.5% and the expenses were 1% of the fund the bonus allocated would be reduced from 3.5% to 2.5%.

What are the free assets?

The *free assets* are the amount of assets in the fund over and above the amount needed to secure all policyholders' guaranteed benefit with some allowance for future bonuses. It is the result of a number of detailed calculations. For LICI UK the *free assets* have been provided entirely by capital from the shareholder.

The *free assets* provide the capital necessary to fund the writing of new business and also to fund exceptional expenditure and other items which cannot rightfully be charged to policyholders.

LICI UK's policy is for the ratio of its **free assets** to its total assets to be in the range of 5% to 25%. The **free assets** are built up by the interest earned on them and by profits arising from miscellaneous sources including profits from non profit business issued from 2004 onwards.

What does the shareholder get?

As stated LICI UK is a Branch of the Life Insurance Corporation of India whose ultimate owner is the Indian Government. Its Articles of Association provide for a maximum of 5% of the emerging surplus to be remitted to the shareholder (in other words at least 95% of surplus is distributed to policyholders). In addition LICI UK sends money back to India to allow for expenses occurred there in connection with the management of the Branch. The amount is based on the premium income of the Branch.

What if I have any questions?

Please contact LICI UK at 08000 685 712 and we will be pleased to try and help you.

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

LICI UK is a trading name of the Life Insurance Corporation of India which is registered in England and Wales,
Company Number FC005008. Main Office: York House, Empire Way, Wembley, Middlesex HA9 0PX.

The Life Insurance Corporation of India is authorised and regulated by the Financial Services Authority. (FSA) Entered on the FSA Register, registration number 110379.
We only provide information and advice on the Protection, Pension, Savings and Investment products and services from our own range.

www.liciuk.com