



Phoenix & London Assurance Limited

Annual report to with-profits policyholders by the Board of Phoenix & London Assurance Limited for the period 1 January 2009 to 31 December 2009

Purpose

We set out how we manage the Phoenix & London Limited With-Profits Fund ('the fund') in our Principles and Practices of Financial Management (PPFM). In this report we give details of how we have complied with the PPFM for 2009.

Phoenix & London Assurance Limited has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders. This report deals with how Phoenix & London Assurance Limited has exercised its discretion in these areas.

Background

Phoenix & London Assurance Limited was previously known as Sun Alliance and London Assurance Company Limited.

Our PPFM is available on our website at www.phoenixlifegroup.co.uk, or you can ask us for a copy. We have produced a shorter guide called 'How we manage the Phoenix & London Assurance Limited With-Profits Fund' and this can be obtained in the same way.

The with-profits policies fall into three main types. These are:

- traditional with-profits;
- unitised with-profits bonds; and
- other unitised with-profits.

Independent review

The company formally consulted with, and took into account the opinions of the With-Profits Actuary and the With-Profits Committee (a committee which is independent by virtue of its majority of independent members) in respect of all material changes during 2009. This included consultation on the changes to bonus rates, surrender values and guarantee charges.

The 2009 Scheme was subject to independent actuarial review, review by the Financial Services Authority and was approved by the UK High Court.

Summary

Payouts for with-profits policies depend on the discretion exercised by Phoenix & London Assurance Limited. The interests of with-profits policyholders are protected by the PPFM of the company.

Each year the Board will produce a report to you, the with-profits policyholders, summarising compliance with the PPFM and how any discretion has been used over the previous year.

The PPFM principles cover the following areas:

- Amounts payable under a with-profits policy
- Annual bonus rates
- Final bonus rates
- Smoothing
- Surrender values
- Investment strategy
- Business risks
- Expenses and charges
- Management of excess assets
- New business
- Equity between the fund and shareholders

These are expanded on in the sections below. In addition, there is a commentary on any changes to the PPFM, other significant events and communications to with-profits policyholders during the year.

Amounts payable under a with-profits policy

We aim to pay all policyholders their fair share of the profits which the fund has earned over the time they have held their policy. We pay the share of profits in the form of annual and final bonuses. When deciding what is a fair share we consider the underlying value of representative specimen policies (sometimes called the 'asset share') as a guide. The underlying value of policies reflects the premiums paid and the investment performance of the fund over the lifetime of the policies, after allowing for factors such as our costs, the tax we have to pay, the shareholders' share of profits, charges for death benefits, charges for guarantees and other profits and losses. This was the approach we used over 2009.

The outcomes we describe below relating to bonus rates, smoothing, surrender values and investment strategy are all measured by reference to representative specimen policies rather than to each actual policy.

In the Board's opinion, the methodology used to calculate the underlying value of policies has been in line with the PPFM. Further, in the Board's opinion, the discretion applied to the methods used to determine payouts on all policies during 2009 has been in line with the PPFM.

Annual bonus rates

We declared annual bonus rates for 2008 in March 2009 as part of the 2008 year end valuation. We maintained the same rates as those for 2007. For unitised with-profits policies other than final salary group pension policies, where we declare annual bonus rates in advance, we maintained the same rates from January 2009 as those from January 2008. For final salary group unitised with-profits pension policies where we declare annual bonus rates in advance, we maintained the same rates from March 2009 as those from March 2008.

We reviewed annual bonus rates for 2009 in December 2009. We subsequently declared these annual bonus rates in March 2010 as part of the 2009 year end valuation. We maintained the same annual bonus rates as those for 2008. The annual bonus rates for 2009 are shown in the table below.

For unitised with-profits policies other than final salary group pension policies, we declare annual bonus rates in advance and the rates from January 2010 are the same as the rates from January 2009. For final salary group unitised with-profits pension policies we declare annual bonus rates in advance and the rates from March 2010 are the same as the rates from March 2009.

Type of traditional with-profits policy and bonus series	Annual bonus rate for 2009	
	On the basic sum assured	On previously added bonuses
UK life	0.10%	0.10%
UK pension (pure endowment)	0.05%	0.05%
UK pension (deferred annuity)	0.10%	0.10%
Non sterling assurances	0.10%	0.10%

Type of unitised with-profits policy and bonus series	Annual bonus rate in advance	
	On the unit value	Applies from
Bond started before 29 Sep 1997	0.50%	January 2010
Life other	0.50%	January 2010
Pension (other than final salary group pension)	1.00%	January 2010
Final salary group pension	2.00%	March 2010

We declared interim annual bonus rates for 2009 and 2010 at the same rates as the 2008 and 2009 annual bonus rates respectively.

The Board is satisfied that the approach taken in determining annual bonuses during the year was in line with the PPFM.

Final bonus rates

For unitised with-profits bonds, we changed final bonus rates each month during 2009. For final salary group unitised with-profits pension policies, we reviewed final bonus rates at the end of each quarter during 2009. For other policies, we changed final bonuses on 1 January 2009, 1 July 2009 and, due to the unusual investment conditions, also on 1 October 2009.

We also reviewed final bonus rates to apply from 1 January 2010.

For some policies where the value of guaranteed benefits already exceeded the underlying value, we did not add any final bonus.

The Board is satisfied that the changes to final bonus rates resulted in changes to payouts that were consistent with the PPFM and were consistent with treating customers fairly.

Smoothing

We generally limit the changes in final bonuses to restrict differences in total maturity payouts (sum assured, annual bonus and final bonus) on similar maturing policies to 7.5% at each half yearly final bonus review and to 15% from one year to the next. For some retirement annuity policies where payout ratios were significantly out of line with 100% of the underlying value, we allow larger differences of 10% at each review and 20% over a year.

However, due to the unusual investment conditions, for the January 2009 final bonus changes, we allowed an additional 5% reduction in total maturity payouts before smoothing applied. This meant that we generally limited reductions in total maturity payouts to 12.5% compared to similar maturity payouts in July 2008.

We also allowed an additional 5% reduction in total maturity payouts for the 1 July 2009 final bonus changes. This generally limited reductions in total maturity payouts to 12.5% compared to similar maturity payouts in January 2009.

We made an interim review to generally increase final bonuses from October 2009. We generally allowed an increase in total maturity payments of up to 12.5% compared to similar payouts in July 2009.

We allowed an additional 5% increase in total maturity payouts for the 1 January 2010 final bonus changes. This generally limited increases in total maturity payouts to 12.5% compared to similar maturity payouts in July 2009.

For unitised with-profits bonds where we change final bonuses each month we look at the investment return averaged over 3 years to determine how we should smooth any changes.

For final salary group unitised with-profits pension policies we generally limited changes in final bonus rates to 5% at each quarterly review.

The Board is satisfied that these movements in final bonuses and maturity payouts in 2009, were necessary to keep payouts reasonably in line with the underlying value of policies, to ensure fairness between groups of policyholders and to protect the financial position of the fund, and were in line with the PPFM.

Surrender values

- For traditional business, during 2009, we broadly set surrender values with the aim of paying 100% of the underlying value less a 5% adjustment which gradually reduces to nil over the last 10 years to maturity. The adjustment is to protect the interests of continuing policyholders from bearing an increased share of the risks in the fund. Where the value of the guaranteed benefits was significantly higher than the underlying value, some allowance was made for the value of these guarantees. We reviewed the way we calculate surrender values at the end of 2009 with revised surrender values applying from 1 January 2010. Surrender values include an allowance for final bonus and these final bonus allowances were revised from 1 January 2009, 1 July 2009, 1 October 2009 and 1 January 2010 in line with changes in final bonus rates.
- For unitised with-profits business, we based surrender values on the value of the with-profits units and final bonus, subject to the potential application of a market value reduction (MVR). If the underlying value was less than the value of the with-profits units, then no final bonus was added and we applied a market value reduction which reduced the value of the with-profits units, so that the surrender value reflected the underlying value. We apply market value reductions to ensure fairness to all with-profits policyholders, so that surrender values are not unfairly higher than the policies' share of the underlying value of the fund's assets.

We changed market value reductions at the same time we changed final bonus rates. For unitised with-profits bonds, we changed them each month, for final salary group unitised with-profits pension policies, we changed them each quarter and for other policies, we changed them on 1 January 2009, 1 July 2009, 1 October 2009 and 1 January 2010.

In the Board's opinion, the methodology used to determine surrender values has been in line with the PPFM.

Investment strategy

During 2009, we invested the fund in a mix of higher risk assets such as company shares (equities) and property, and lower risk assets such as fixed interest stocks (bonds, types of loan usually issued by the Government or companies) and cash deposits. We held different mixes of assets for different groups of with-profits policies.

- For policies with guaranteed benefits that are high compared to the underlying value, we held fewer higher risk investments.

- For policies where the guaranteed benefits are particularly high, we held solely lower risk investments.
- For policies that have exposure to higher risk investments, we reduced the proportion of these higher risk investments as the policies got closer to maturity.

Of the fixed interest stocks, about half are invested in UK government stocks (gilts) and half are invested in non UK government stocks.

The proportions of higher risk investments are generally unchanged, other than arising from the reductions in the proportion as policies get closer to maturity, or from reductions where a fall in the underlying value caused the guaranteed benefit to be particularly high relative to the underlying value.

Where the fund invests in corporate bonds (types of loans issued by companies) we normally only invest in bonds with a high credit rating. During 2009, the credit rating was reduced on a number of the bonds we invested in, so that we had a higher proportion of lower rated bonds than we would normally aim to hold. On the advice of our investment managers we continued to hold most of these bonds and, over 2009, there was a very strong recovery in the overall value of these investments following the falls in value in 2008. It is likely that in the near future our exposure to lower rated bonds will remain higher than it has been in the past. Despite these holdings, the overall quality of our bond investments remains good.

The yearly statement that we send to with-profits policyholders includes information about the mix of assets for with-profits policies.

Going forward, 2009 Scheme policies will typically have a larger investment in company shares (equities) and property than non 2009 Scheme policies. For 2009 Scheme policies we expect to increase the approximate company shares (equities) and property proportions over 2010 up to 45% and 25% respectively.

The fund also contains investments which back the non-profit business, the cost of guarantees and the cost of smoothing.

The Board is satisfied that the approach taken in following the investment strategy during the year was broadly in line with the PPFM.

Business risks

There was an annual review by the Board of existing business risk exposure. In the opinion of the Board, appropriate measures were taken to limit the with-profits business exposure to risk to amounts which are fair.

The Board is satisfied that it has managed its business in line with the PPFM, that is, in a prudent manner, having regard to both the risks and rewards of which it is aware.

Expenses and charges

During 2009, we charged a fair share of our expenses to the fund and we made an appropriate allocation to the underlying value of with-profits policies in the fund. The main expenses we charged to the fund in 2009 were due to:

- Management services

During 2009, Pearl Group Management Services provided all the services required to operate the fund apart from investment management services. The charges are mainly expressed as an annual amount per policy which increases each year linked to the increase in the Retail Prices Index.

Pearl Group Management Services made additional charges for certain one-off activities and developments and we generally apportioned such costs in a fair and reasonable manner, taking into account the beneficiaries of the activity.

- Investment management services

During 2009, investment management services for the fund were provided by Ignis Asset Management. The charges made by Ignis Asset Management in respect of the fund's investments were attributed to the fund.

- Direct and other costs

The Board is satisfied that we apportioned a fair share of the direct and other costs we incurred to the fund and that these were in line with the PPFM.

Allocation of taxation

We allocated a share of the provisional amount of tax we incurred to the fund, in line with the PPFM. Once we have agreed our tax charge with HM Revenue & Customs (HMRC), we will review the amount of tax we have allocated to the fund to ensure it is fair.

We made an appropriate allocation of tax to the underlying value of with-profits policies in the fund.

Cost of guarantees

The policies in the fund provide a number of guarantees and these vary according to the type of policy held. These guarantees include guaranteed annuity options. We make a charge to the underlying value of policies to cover the expected costs of providing these guarantees.

For final salary group unitised with-profits pension policies, we made a charge for the cost of guarantees when we reviewed final bonus rates. The charge was unchanged at 10% of the underlying policy value in excess of the value of the units.

We reviewed the charges for the cost of guarantees twice during 2009 and no change was made to the level of charge. The January 2010 charges are:

- an annual charge of 1.5%; and
- an exit charge of 7.5% in 2010, which we expect to reduce each year to nil for exits in 2015.

For 2009 Scheme policies, there are no further charges for the cost of guarantees from 1 January 2010.

The Board is satisfied that we apportioned a fair share of the cost of guarantees in line with the PPFM.

Management of excess assets

We aim to manage the size of the excess assets, so that the excess provides at all times an adequate but not excessive margin against an adverse outcome compared with our assumptions. The excess assets are the value of the assets over the amount we consider necessary to enable us to pay all guaranteed amounts when due, and to pay discretionary benefits so as to treat policyholders fairly relative to their reasonable expectations and to other current and past policyholders.

In the Board's opinion, the methodology used to calculate the excess assets has been in line with the PPFM. Furthermore, in the Board's opinion, the use of the excess assets to demonstrate sufficient capital in the company has been in line with the PPFM.

New business

The fund is no longer actively seeking new business. The Board is satisfied that this is in line with the PPFM.

Equity between the fund and shareholders

Our shareholders received a share of the distributed profits. For traditional with-profits policies, this was equal to one ninth of the value of bonuses we distributed to with-profits policyholders. For unitised with-profits policies, this was equal to five ninety fifths of the value of bonuses we distributed to with-profits policyholders. For pension policies, we reduced the amount received by shareholders to allow for the associated tax. We charged the fund for any tax arising from the distribution of profits from the fund to the shareholders. The shareholders' share of distributed profits for 2009 was £0.9m.

The shareholder provided financial support to the fund in 2009 in the form of loans. Interest was payable to the shareholder at a commercial rate for this support (although the fund was able to offset some of the interest cost by earning an investment return on the loaned amounts). The loan support will be repayable only to the extent that the fund has sufficient surplus.

The Board is satisfied that the shareholders' share of the distributed profits for 2009 is in line with the PPFM.

Changes to the PPFM during 2009

We include a description of the recent changes to the PPFM with the annual statement we issue to with-profits policyholders.

2009 Scheme

We wrote to policyholders in May / June 2009 about our proposal to remove the guaranteed pension rate for certain individual pension policies with a stated retirement date on or after 1 January 2020. In return we would increase the immediate value of the policy and change our investment strategy for these policies. We call this proposal the 2009 Scheme. It was approved by High Court and became effective from 31 December 2009. We refer to these policies, assuming they did not choose to opt out of the scheme, as the 2009 Scheme policies.

For policies other than the 2009 Scheme policies, there will only be a small effect, if any in the way in which we manage the fund. For the 2009 Scheme policies, the changes are material and were covered in the letter and booklet we sent to those policyholders in May / June 2009.

The January 2010 PPFM was updated to allow for the 2009 Scheme. In the booklet we included with the May / June 2009 mailing, we included details of the changes to the principles and described the other changes. For 2009 Scheme policies, further information was included in the September / October 2009 decision pack mailing. The update to the PPFM also included some additional undertakings which we gave to the High Court in connection with the 2009 Scheme.

Communications to with-profits policyholders

During 2009, we provided with-profits policyholders with key information concerning annual bonuses, investment mixes and changes to the PPFM with their annual statement.

We sent final salary group unitised with-profits pension policyholders an updated guide to how we to manage the with-profits in 2009, to reflect that we no longer reassured these policies to the Phoenix Life Limited 100% With-Profits Fund.

In 2010, we will send with-profits policyholders, other than those with final salary group unitised with-profits pension policies, an updated guide to how we manage the with-profits fund to reflect the 2009 Scheme. These replace the equivalent guides we sent in 2006. The guides are available on our website at www.phoenixlifegroup.co.uk, or you can ask us for a copy.

Conclusion

It is the opinion of the company that the Phoenix & London Assurance Limited With-Profits Fund was, in all material respects, managed in accordance with the PPFM over 2009.

The With-Profits Committee has reviewed this annual report to with-profits policyholders and does not wish to make any additional or separate reports.

The Directors of Phoenix & London Assurance Limited

June 2010

Report to with-profits policyholders by the With-Profits Actuary of the Phoenix & London Assurance Limited With-Profits Fund for the period 1 January 2009 to 31 December 2009

Purpose

The Principles and Practices of Financial Management (PPFM) for Phoenix & London Assurance Limited ('the company') is a detailed document which sets out how the company manages its with-profits business.

The company has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of my report to the company's with-profits policyholders is to give my opinion, as required by the rules of the Financial Services Authority, as to whether the company has taken the interests of with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2009.

Conclusion

In my opinion, the company has taken the interests of the with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2009.

My opinion is based on the information which the company provided to me during the year.

The Board for Actuarial Standards has issued a Technical Actuarial Standard on Reporting ('TAS R') which applies to reports produced by actuaries. My report, when considered alongside the information in the company's own report to which my report is annexed, together with the other information provided to policyholders in relation to 2009, is intended to comply with TAS R.

Andrew Burke
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With-Profits Actuary
June 2010