

# **PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT**

**LEGAL & GENERAL ASSURANCE  
SOCIETY LIMITED**

**REPORT TO WITH PROFITS POLICYHOLDERS ON  
COMPLIANCE FOR 2019**

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## 1. INTRODUCTION AND SUMMARY

The Board of Legal & General Assurance Society (the Society Board) published its Principles and Practices of Financial Management (PPFM) for its with profits business on 30 April 2004. Revised PPFMs were published on 29 June 2005, 29 June 2007, 31 December 2007, 30 June 2012, 31 July 2013, 19 February 2015, 21 June 2017, 5 October 2018 and 28 January 2020.

Each year, the Society Board must report to with profits policyholders on compliance with its obligations relating to the PPFM. These obligations require companies to establish governance arrangements designed to ensure that they comply with and maintain PPFMs for their with profits business.

**In the opinion of the Society Board it has complied with the obligations in relation to its PPFM over the period 1 January 2019 to 31 December 2019, including the bonus declaration for the year ending 31 December 2019, announced on 20 February 2020.**

The reasons for reaching this conclusion are presented in this report, which covers:

- Governance arrangements for with profits business;
- The Society Board's compliance with its PPFM in the exercise of discretion in the management of its with profits business;
- Competing or conflicting rights, interests and expectations; and
- Communications with policyholders and PPFM changes in 2020.

The With Profits Actuary advised the Society Board on the operation of the with profits business, including the exercise of discretion and potential conflicts of interest. The With Profits Committee provided independent judgement relating to the management of the with profits business and compliance with the PPFM. This report includes statements from both the With Profits Committee and the With Profits Actuary.

## 2. PROPOSED TRANSFER OF WITH PROFITS BUSINESS TO REASSURE

In December 2017 Legal & General announced the sale and proposed transfer of its traditional insurance-based savings, pensions, life and with profits business to ReAssure Limited (ReAssure). This sale included the Society's With Profits Fund.

The Society also sent affected policyholders and other interested parties an information pack relating to the proposed transfer to ReAssure. The information pack provided full details of the Scheme and was made available on the Society's website alongside other relevant material and reports.

## 3. GOVERNANCE ARRANGEMENTS FOR WITH PROFITS BUSINESS

During 2019 the Society Board retained responsibility for all decisions relating to the management of the With Profits Fund, subject to a requirement to obtain consent from ReAssure Limited in relation to certain material matters such as any estate distribution.

The With Profits Committee was a sub-committee of the Society Board during 2019 and was chaired by an Independent Chairman. The Committee comprised four members, who collectively meet the independence criteria required by the Financial Conduct Authority. One role of this Committee was to provide independent judgement on the exercise of discretion in relation to the Society's with profits business, on compliance with its PPFM and on how competing or conflicting rights and interests of policyholders and shareholders have been addressed.

The With Profits Committee met regularly during 2019 with the Society's senior management team responsible for the with profits business and reviewed all the key decisions affecting with profits policyholders including the bonus declaration for the year ending 31 December 2019.

The Society's With Profits Actuary, authorised by the Prudential Regulatory Authority (PRA), provided advice to the Society Board on the exercise of discretion in relation to with profits business, compliance with the PPFM and the interests of the with profits policyholders.

## 4. COMPLIANCE WITH THE PPFM IN THE EXERCISE OF DISCRETION

The main areas in which discretion is exercised in the operation of with profits business are:

- Declaration of bonus rates;
- Investment policy and the arrangements for investment management;
- Setting surrender values (and transfer values for pension business) and market value reduction factors (MVRFs);
- New business terms and volumes;
- Apportionment of expenses and charges;
- Management of the Inherited Estate.

#### 4.1 Bonus rates

Decisions regarding bonus rates were taken by the Society Board, having received advice from the With Profits Actuary. The bonus declaration was guided, for most with profits business, by the smoothing formulae used in recent years and designed to achieve the aims stated in the PPFM.

The reports on bonus rates presented to the Society Board provided evidence that the bonus methodology was based around the stated aims and followed the approach set out in the PPFM. The material assumptions used in determining bonus rates were presented to the Society Board for approval.

The bonus rates declared demonstrated clear differentiation between product types and generations, in accordance with the PPFM.

While investment returns are usually the most important factor in determining bonus rates, allowance is made for operating experience within the With Profits Fund, such as surrender, expense and mortality profits or losses. The work carried out to investigate operating experience grouped together similar policies. Allowance was also made for tax.

The Contractual Minimum Addition (CMA) applicable to certain of the Society's contracts was calculated and applied in line with the formulae set out in the PPFM.

#### 4.2 Target ranges

The Society's PPFM contains target ranges for payout ratios on with profits policies. The target range for both maturities and surrenders is 80% to 120% of asset share. These ranges were last reviewed during 2017 and were found to appropriately reflect the aims of the Society to achieve fair customer outcomes whilst allowing an appropriate degree of smoothing which is a key element of with profits products.

The Society manages its with profits business with the aim that at least 90% of payouts fall within the target range. Analysis of maturity and surrender claims has confirmed that the Society complied with its policy on target ranges during 2019.

To ensure ongoing compliance, payout ratios are regularly monitored throughout the year so that bonus rates and market value reduction factors (MVRFs) can be adjusted if necessary.

#### 4.3 Surrender values

Surrender values (and transfer values for pension business) and MVRFs were regularly monitored throughout 2019, with changes made in accordance with the PPFM and consistent with past practice, having regard principally to movements in the value of the underlying investments.

No changes were made during the year to the overall approach and methods used to determine surrender and transfer values for conventional business and MVRFs for unitised business.

#### 4.4 Investment policy

The Society Board and its committees regularly monitor investment performance and are required to approve any proposed changes in policy. Asset allocation, counterparty exposure, liquidity and performance, together with deviations from benchmarks, are monitored monthly and action is taken to ensure these remain in line with the investment policy. There are separate guidelines for assets backing asset shares (whose returns directly influence bonus rates) and assets backing the cost of guarantees on with profits business, the Inherited Estate and other liabilities. The With Profits Fund continued to be managed in a manner consistent with the overriding principle that its assets should be sufficient to meet its liabilities, whilst maintaining a balance between risk and return for policyholders and the With Profits Fund as a whole.

The proportion of the assets backing asset shares invested in fixed interest securities and equities remained broadly the same over the year.

In order to partly protect the With Profits Fund's capital position against possible changes in equity, property, corporate bond and government bond prices, hedging positions were held within the Inherited Estate. The costs and benefits of this hedging accrue to the Inherited Estate and do not directly affect the investment returns credited to asset shares.

A revised schedule of the investment management fees payable to Legal & General Investment Management Limited (LGIM) was agreed and implemented on 1 April 2018, this schedule applied during 2019.

#### 4.5 New business terms and volumes

The Society closed to new with profits business on 31 January 2015. However, new members to existing group personal pension schemes were permitted during the year.

Each year we review the effect of writing new business on the With Profits Fund and on existing with profits policyholders. This review was completed in 2019 and appropriate action was taken to ensure that new business is not expected to have an adverse effect on either the Fund or its with profits policyholders. We will review the impact of the new business written in 2020 prior to the expected transfer to ReAssure in order to ensure that it does not generate any expected adverse impact on existing policyholders.

#### 4.6 Expenses and charges

The Society established an expense agreement which came into force on 1 January 2018 and applied for the whole of 2019. Under this agreement, the majority of the expenses of the With Profits Fund were replaced by a fixed amount per policy, varying by policy type. The majority of investment management expenses, commission and any rectification payments to policyholders are not included within the expense agreement.

Judgements as to the level of support from the Inherited Estate, for example by limiting the amount of transfer to shareholders or expenses deducted from policies when determining levels of benefits, were taken by the Society Board alongside the main bonus investigation exercise. In general, decisions relating to these matters were made at the product launch date (or date of subsequent review). Decisions on the treatment of exceptional expenses were made by the Society Board.

Certain pension plans currently benefit from our Stakeholder Charge Cap under which the value of the plan will not be less than it would have been if they had transferred to a Stakeholder Pension in April 2001. When operating this cap for with profits policies the Society applies some averaging to the charge refunds in order to remain consistent with the approach to grouping used in formulating bonus rates.

With profits customers aged 55 or over at the time they access their pension pot have any exit charges that may apply to their plan capped at 1% of their total pension pot.

A framework for assessing the level of deductions from asset shares in respect of the cost of guarantees and options was introduced in the 29 June 2005 PPFM. Following the closure of the With Profits Fund to new business, this framework was discontinued. As outlined in section 4.7 the Board assesses annually whether any part of the estate should be distributed to policyholders and any charges or refunds with respect to guarantees and options are now incorporated into this assessment.

#### 4.7 Management of the Inherited Estate

The With Profits Fund contains an excess of assets over liabilities known as the Inherited Estate, which is used to provide freedom for the Fund's investment policy, enable smoothing of benefits, absorb financial strains and provide support for expenses and to meet part of the cost of shareholder transfers. Management of the Inherited Estate is therefore critical to the financial health of the With Profits Fund and the continuation of with profits business.

The Inherited Estate and assets backing the cost of guarantees and options follow a different investment strategy to that for the assets backing asset shares. This strategy, coupled with the estate distribution mechanism, and the hedging of certain market risks, is designed to protect solvency in adverse conditions and provide greater stability.

The Board is required to consider the size of the Inherited Estate annually with a view to assessing whether any may be distributed or whether a charge is required to increase its size. The Board considered the size and projected run off of the Inherited Estate in 2019, and concluded that a distribution of the estate was appropriate and would not adversely affect the management of the Fund in future. The Board considered the method of distribution and whether any adjustments for charges or refunds in respect to guarantees and options were required. As a result there was a distribution of the estate of 0.5% of asset shares in 2019 which was reflected in the bonus rates.

## 5. COMPETING OR CONFLICTING RIGHTS, INTERESTS AND EXPECTATIONS

### 5.1 Equity between with profits policyholders and shareholders

Audited accounts provided evidence of the separate treatment of the With Profits Fund. The calculation of distributed surplus and shareholder transfer from the With Profits Fund was consistent with the statements made in the PPFM.

#### 5.1.1 Apportionment of tax and expenses

Inequity between with profits policyholders and shareholders could occur from the apportionment of tax and expenses between the With Profits Fund and the rest of the Society. The Society has an established practice of charging to the With Profits Fund an amount of tax calculated on a stand-alone basis, thus addressing this potential conflict. This practice continued in 2019. Expense processes are in place, so that an appropriate split of expenses between the With Profits Fund and the other parts of Legal & General can be achieved, reflecting the expense deal in place.

#### 5.1.2 Distribution of surplus

Shareholders are entitled to not more than 10% of distributed surplus from the With Profits Fund, but may be required to provide support if the With Profits Fund is in financial difficulty. Both policyholders and shareholders have an interest in the controlled distribution of surplus, including the split of the distribution to policyholders between annual and final bonus, and in the continued prudent financial management of the Fund.

It has been the established practice that shareholders receive 10% of distributed surplus from the With Profits Fund, and that additional tax due in respect of this transfer is charged to the Inherited Estate. For certain new business written after 1 July 2012 the percentage of distributed surplus receivable by the shareholders is reduced. The Society continued this practice in 2019.

The UK regulatory regime changed in 2016, resulting in a change to the methods and assumptions required for the calculation of the With Profit Fund liabilities. However, the basis of the amount paid to shareholders in respect of 2016 to 2019, along with the amount deducted from policyholder assets to contribute to this amount, continued on the previous calculation methodology. The financial impact of this on the Fund and policyholders was immaterial.

During 2019 a small error in the calculation of the historic shareholder transfers was identified and reported to a sub Committee of the Board. Appropriate action was taken to ensure that the error would not have an adverse effect on either the Fund or its with profits policyholders resulting in a small refund to the Fund.

### 5.2 Equity between different groups of with profits policyholders

Different groups of with profits policyholders may have competing or conflicting rights, interests or expectations. For example, holders of:

- different products;
- policies of different sizes or policy terms;
- policies with different entry or maturity dates,

or policyholders:

- of different ages;
- claiming for different reasons (e.g. maturity, death, surrender);
- exercising different policy options,

could receive different benefits relative to each other depending on how discretion is exercised.

The main areas in which judgement and discretion are exercised in balancing the interests of these groups are in the:

- smoothing of policy benefits;
- grouping of policies for setting bonus rates and surrender values and sharing of investment and other experience;
- relative levels of benefits paid on surrender or maturity;
- allocation of asset mix and investment returns;
- level of risk embedded in the non-participating business held.

Where bonus rates are guided by asset share calculations, a consistent approach to smoothing across product types was applied, in which a proportion of investment and other experience was not immediately reflected in policy benefits at contractual points. In the minority of cases where bonus rates are not guided by asset share calculations, other techniques, such as comparison with similar products whose bonus rates are guided by asset share calculations, were used in order that a consistent approach to smoothing could be applied across different groups of policies.

The approach of grouping of policies has evolved gradually and depends on the different aspects of experience (such as investment returns, expenses and mortality). For a particular aspect of experience, policies judged to have similar characteristics were grouped together, in order that a practical and equitable approach to the sharing of experience could be achieved.

Surrender values were reviewed with the aim that payments to those policyholders taking benefits other than at contractual points did not adversely affect the interests of remaining with profits policyholders.

Exercise of discretion in the setting of investment policy, used in the determination of investment returns applicable when setting policy benefits, and the split of asset mix between different groups of policies, is performed taking into account the nature and relative values of guarantees and options provided on different group of policies.

**The Society Board confirms that, in its opinion, these potentially competing or conflicting rights, interests and expectations of policyholders were managed in accordance with the PPFM.**

## 6. COMMUNICATIONS WITH POLICYHOLDERS AND CHANGES TO PPFM

Statements setting out details of the bonuses added to their policies following the 20 February 2019 bonus declaration were sent to policyholders and they also received information on investment performance, the asset mix applicable to their policy and how investment performance affects bonus rates.

During 2019 a number of guides and factsheets including guides on how we manage policyholders' with profits investments, the annual bonus factsheet and the report to policyholders on compliance with the PPFM were available on the Society's website.

In January 2020 a minor amendment was made to the PPFM. We updated the PPFM to confirm that the expense agreement from 1 January 2018 between the Society and the With Profits Fund continues until June 2020, but may be extended by the Society beyond that date.

An information pack relating to the transfer of the business to ReAssure was also sent to affected policyholders and other interested parties.

## 7. STATEMENT FROM THE WITH PROFITS COMMITTEE

The With Profits Committee provided independent oversight of the management of the Society's with profits business for the period 1 January 2019 to 31 December 2019. The With Profits Committee assessed, challenged and provided advice to the Society's Board on key proposals affecting the With Profits Fund over the period, most notably including the sale of the With Profits Fund to ReAssure Limited.

The With Profits Committee has reviewed the management of the Society's with profits business over the period 1 January 2019 to 31 December 2019, the With Profits Actuary's report on PPFM compliance and the LGAS Board report to with profits policyholders. The With Profits Committee has confirmed that it is satisfied that any competing or conflicting rights and interests of policyholders and shareholders were reasonably addressed and is also satisfied with the contents of the Board's report.

## 8. APPENDIX

### Report of the With Profits Actuary to the with profits policyholders of Legal & General Assurance Society Limited

The Financial Conduct Authority's rules require an actuary appointed to perform the With Profits Actuary function to report to the with profits policyholders as to whether the annual report of the firm and the discretion exercised by the firm in respect of the period covered by the report may be regarded as having taken the interests of the with profits policyholders into account in a reasonable and proportionate manner.

This is my report for the financial year ended 31 December 2019. In producing this report, I have based my opinion on the information and explanations provided to me by Legal & General Assurance Society Limited ("the Society"), having regard to the Principles and Practices of Financial Management ("PPFM") of the Society's With Profits Fund (effective October 2018). I have also had regard to the relevant Technical Actuarial Standards issued by the Financial Reporting Council.

I have carried out a review of the Society's compliance with the PPFM and its exercise of discretion over 2019. A key element of the Society's use of discretion is the setting of bonuses and hence payouts to customers.

I am satisfied that the Society has complied, in all material respects, with the principles and practices set out in the PPFM for the year ended 31 December 2019. I am satisfied that the Society's report and its exercise of discretion over this period may be regarded as having taken the with profits policyholders' interests into account in a reasonable and proportionate manner.

**Tricia Ross FIA**  
**With Profits Actuary**



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