

Annual report to  
Policyholders for 2009



CLERICAL MEDICAL

## Introduction

This annual report tells you how we have managed our With-Profits Fund in line with the published principles and practices – our PPFM. The PPFM goes into great detail, focusing on the standards, methods and controls we use to ensure we run with-profits fairly. It also explains how we respond to changes in the economic environment.

Clerical Medical Investment Group Limited (we use ‘Clerical Medical’ or ‘we’ in the rest of this document) runs one With-Profits Fund. All the different types of with-profits policies sold in the UK, Europe and other overseas markets are supported by the same fund.

This annual report for the year 2009:

- describes the decisions we took in managing the fund and
- responds to frequently asked questions.

If you have any further questions please contact us on Tel. +31 43 356 5000.

The Board of Clerical Medical met on 25 March 2010 to consider the issues covered in this report and the evidence presented to them by the With-Profits Actuary. The Directors are satisfied that the With-Profits Fund has been managed in accordance with the Principles and Practices of Financial Management in all material respects.

The Directors of Clerical Medical  
31 March 2010

## 1. Aims of investment and bonus policy

When we decide the investment strategy and decide bonus rates, our aim is to achieve fairness between different types and groups of with-profits policyholders, and between them and our shareholders. We believe fairness is achieved:

- By aiming to pay out a fair share of investment performance to each investor.
- By aiming to achieve growth over the long term whilst ensuring that we can meet the Fund's guarantees. We do this by having a significant proportion of the assets in higher-risk assets such as company shares and property.
- By aiming to smooth through some of the peaks and troughs of stock market values, and
- By adding regular bonus. We have to bear in mind that, where guarantees apply, we cannot take away regular bonuses once we have added them to your investment. This means that we set the rate lower than we otherwise might do.

## 2. Frequently Asked Questions

### Question 1: What were investment returns like in 2009?

Over the first part of 2009, investment conditions continued to be very difficult, following on from the severe market turbulence in 2008. Over the rest of the year, markets recovered significantly. The With-Profits Fund was strong enough to be able to continue investing a significant part in shares and property even after the falls of 2008 and early 2009 (see Question 2), and so was able to benefit from the recovery in the second part of the year.

Positive returns were earned in 2009, following negative returns in 2008. For example, the return for Euro GGF 2001 policies was 18.1% (-20.8% in 2008).

After allowing for tax, smoothing, and any policy charges set out in your policy documentation this will be reflected in policies' values when they mature or are cashed-in in the future. We will pay guaranteed amounts if higher.

### Question 2: What is your investment policy?

We monitor and manage the assets in which the Fund is invested and will change them depending on:

- our view of investment market conditions
- the total amount of guarantees provided on policies in the Fund.

Rather than have one investment strategy for the whole fund, we have a different investment strategy for each part of the fund's assets.

- The asset shares principally drive future bonus amounts and therefore policy payouts. That is, they are usually invested in a significant proportion of higher risk assets which have the potential for higher returns and therefore growth.
- The assets known as the estate are held as reserves to provide a cushion against the effects of poor investment conditions and therefore help protect the value of your investment. We have a more cautious investment strategy for this part of the fund than we do for the asset shares. This helps keep the value of the estate stable, which in turn allows us to keep the asset shares invested in higher risk assets.

This careful approach means that in 2009 we did not have to change the proportion in company shares and property (the equity backing ratio - EBR) of the assets used as the principal factor in determining payouts. The rest is in lower-risk investments such as fixed-interest bonds. These include bonds issued by the UK Government, and bonds issued by companies that carry a higher element of risk but offer higher returns.

For detailed up-to-date information on where the Fund is invested please refer to our 'With-profits investment factsheet'. This is available from your financial adviser or from our website [www.clericalmedical.be](http://www.clericalmedical.be).

### **Question 3: How did you set regular bonuses in 2009?**

The size of the regular bonus depends mainly on what bonuses we have already added, on past investment performance and on what we expect in the future.

We have to bear in mind that, where guarantees apply, we cannot take away regular bonuses once we have added them to your investment. This means that we set the rate lower than we otherwise might do. If we didn't do this, the guarantees in the Fund could become big enough to force us to increase the percentage of the Fund's assets invested in fixed-interest assets. Changing the Fund's assets in this way would mean we would expect to achieve a lower total return on your investment over the long term, even though the guaranteed part might be higher.

We followed this approach in 2009. Although investment conditions remained challenging, we continued to add regular bonus. For most bonus classes, we kept rates at the previous levels – for example 0.5%pa for the main life and pensions unitised classes of policy. For newer bonus classes, which had higher rates, we reduced the rates by 1% to between 0.5% and 1.5%. We will review the rates in future, in line with the principles and practices of the way we manage the With-Profits Fund. We may reduce the rates if we think it's necessary for the overall objectives of the fund.

### **Question 4: How did you set final bonuses and MVAs that applied to payouts in 2009?**

Normally, the investment returns we have not passed on as a regular bonus build up. In this event, we add a final bonus to 'top up' your policy to a fair level.

For unitised policies, when you come to take money out of the Fund, and a guarantee doesn't apply, we may need to make a reduction called a market value reduction (MVA). An MVA would only apply if the value of your units meant your investment would be worth more than your fair share. In this event, the MVA would have the effect of reducing the amount paid out, so that it was in line with your fair share.

Final bonus rates and MVA rates depend on when the investment was made, which helps ensure that performance is shared fairly between policies starting at different times.

Our Claim Bonus Dividend rates have been kept under review, and have been changed in line with our published policy. The large stock market movements in 2009 triggered changes in Claim Bonus Dividend rates at 1 April, 28 May, in addition to the normal six-monthly review at 1 February. At the six-monthly review from 1 August, the decision was taken not to change rates. The changes in rates generally led to payout cuts in February and April, followed by payout increases later in the year.

Surrender values for traditional policies moved with changes in final bonus rates, and the basis was reviewed periodically. Payouts for Guaranteed Growth Fund surrenders have followed the normal process of monthly reviews to reflect the changes in stock markets.

### **Smoothing and guarantee costs**

Smoothing is a unique feature of a with-profits investment. It's designed to spread the effect that rises and falls in investment markets can have on the value of your investment. We aim to smooth through some of the peaks and troughs of stock market values. Smoothing does not lessen the effect on payouts of policies of longer-term changes in the stockmarket.

This smoothing is reflected in the final bonuses. In the first half of 2009 smoothing provided significant protection against the effects of the severe market falls of 2008 and early 2009. The

effect of smoothing reduced as markets recovered later in the year.

We aim to pay amounts that are within 20% of the asset share (as described under the heading 'Target payout ratio' on page 17 of our PPFM). The PPFM target for 90% of payouts being within 20% of asset share was met during 2009. This excludes any policies where payouts are based on guarantees.

Deductions for guarantee costs have been made as they arise and are spread across all the policies in the fund. Some older policies, where a deduction has already been made, and certain policies sold between January 2003 and September 2004, are not subject to this cost. This is in line with our published policy.

#### **Question 5: What changes did you make to the way you manage the fund in 2009?**

##### **Investment strategy and smoothing**

We have made two changes to the way we manage the fund:

- Since late 2008, we have had a different investment strategy for the part of the fund known as the estate (see Question 2)
- We've changed our approach to smoothing which means that bonuses and therefore payouts will go up and down a bit more than they have in the past (see below)

There are times when we have varied the amount of smoothing we apply in order to ensure that the fund is managed in the best interests of our investors. To help support our aim of ensuring that the fund continues to be well equipped to react to a range of investment conditions, we have now reduced the amount of smoothing. Whilst smoothing remains a valuable feature of your policy, this means that bonuses will more closely reflect investment conditions, with payouts potentially higher than before in times of good economic conditions and similarly lower when markets fall.

We mailed all policyholders about these changes in September, and updated both our Principles and Practices of Financial Management (PPFM) and With-Profits Summary.

##### **Change in investment manager**

Following the takeover of HBOS by Lloyds TSB in January 2009, there was a change in investment manager from Insight Investment Management (Global) Limited to Scottish Widows Investment Partnership Limited (SWIP). For the assets backing non-sterling policies, this took place in October 2009. For the assets backing sterling policies, this took place in January 2010. Property assets continue to be managed by Invista Real Estate Investment Management Limited.

#### **Question 6: What other reassurance do I have that you have treated customers fairly and in line with your Principles and Practices?**

There are four main controls in place to ensure this:

- Whenever we make important choices that affect the way we manage our with-profits policies, our With-Profits Actuary advises the Board of Clerical Medical on how these comply with the Principles and Practices of Financial Management.
- Clerical Medical has a Long Term Business Governance Committee. The majority of the members of the committee are non-executive directors, and a non-executive director chairs the committee. The committee reviews any significant transactions and issues that could cause a conflict of interest between you as policyholders and our shareholder (Lloyds Banking Group since January 2009), and makes recommendations to the Board that aim to ensure that the interests of both parties are dealt with fairly.
- We record how our management of the fund is consistent with the Principles and Practices of Financial Management, and the FSA's rules on Treating With-Profits Customers Fairly. The With-Profits Actuary has reviewed this evidence, and he has stated that in his

opinion the interests of policyholders have been taken into account in a fair and balanced way.

- The With-Profits Actuary has reported on this evidence to our Long Term Business Governance Committee and the Board covering the areas where decisions were made, and how they complied with the Principles and Practices of Financial Management

#### **Further information on with-profits:**

We've produced a number of documents on our With-Profits Fund:

- **Principles and Practices of Financial Management ('PPFM')**
- **With-profits summary (a document also referred to as a 'CF PPFM' customer-friendly PPFM)**
- **With-profits investment factsheet**

We provide copies of these documents and the latest information on bonus rates and market value reductions (MVR) on our website [www.clericalmedical.be](http://www.clericalmedical.be).

#### **Report from the With-Profits Actuary**

In my opinion, the discretion exercised by Clerical Medical during 2009, including what is described in this annual report, has taken the interests of Clerical Medical with-profits policyholders into account in a fair and balanced way. I base this opinion on the information and explanations provided to me by Clerical Medical, and taking into account relevant rules and guidance issued by the Financial Services Authority in COBS 20.2 on treating with-profits policyholders fairly.

Neil Holliday  
Fellow of the Institute of Actuaries  
With-Profits Actuary  
31 March 2010