Life Insurance Corporation of India (UK Branch)

Principles and Practices of Financial Management

[2018]

Version [1]

Contents

1 Introduction

1.1 This document (known as the PPFM) sets out the Principles and Practices of Financial Management by which the UK Branch (“the Branch”) of the Life Insurance Corporation of India (“LICI”) conducts its with-profits business. It has been approved by the Corporation’s Board of Management.

1.2 The document has been written to meet the standards required by the Financial Conduct Authority (FCA) according to the relevant rules and guidance as set out in its Conduct of Business sourcebook. Its purpose is to enable a better understanding of the way the Branch conducts its with-profits business and, in particular, the principles and practices adopted by the Board in the application of its discretion. This improved understanding is intended to protect the interests of and promote confidence among with-profits policyholders.

1.3 If a with-profits policyholder makes their policy paid-up, it is no longer eligible to participate in profits. This means that such paid-up policies are not covered by this document.

1.4 All of the Branch’s unit-linked policies that include the option of investment in a with-profits fund are wholly reinsured to a life insurer within the Aviva Group. These policies have the option of investment in the Friends Life FLAS With Profits Fund. Responsibility for that fund rests entirely with Aviva, including bonus declarations, and therefore that business is covered by the Principles and Practices of Financial Management for that fund rather than this document.

1.5 Principles are intended to be enduring statements of the overarching standards adopted by the Branch and are expected to change infrequently. Practices, on the other hand, describe the Branch’s current approach and will be subject to more frequent change but within the principles then applying. The format of this report considers each key area where discretion is applied and sets out firstly the relevant principles, followed by the practices.

1.6 The Branch reviews the PPFM yearly and also when material changes are required either in principles or practices. These changes may be required due to changes in the regulatory, legal or other external factors that could affect the management of with-profit business. Changes are also made to improve clarity for policyholders. The changes are discussed in the Branch Management Committee and also reviewed by the With-Profits Actuary and independent advisor to the with-profit fund of the Branch. Once the changes have been agreed upon, they are placed before the Board of LICI for approval.

1.7 Changes to principles require three months’ notice to with-profits policyholders whereas changes to practices, though they do not require prior notice, must be communicated to policyholders within a reasonable time period by post.The Branch is required to have and has in place governance arrangements to ensure that the conduct of its with-profits business complies with this PPFM document. These include:

i) an annual report to with-profits policyholders from the Board,

ii) a With-Profits Actuary whose responsibilities include advising the Branch's management on key aspects of discretion affecting with-profits business (including the Branch's application of its PPFM), and

iii) a With-Profits Advisory Arrangement whose responsibilities include advising the Branch's Board on the way the with-profits is managed by the Branch and whether this is properly reflected in the PPFM.

1.8 The above documents can be accessed at http://www.liciuk.com/about-us/principles-and-practices/ The PPFM document is available to all policyholders free of charge and can be downloaded from the Branch's website or supplied in paper form on request. Non-policyholders may have to pay for a paper copy.

2 General Principles

2.1 The Branch has four key financial objectives that can be regarded as overriding the principles and practices contained elsewhere herein if they come into conflict. These are:

a) To meet the contractual obligations to policyholders;
b) To meet the tests of solvency and capital adequacy as required by regulatory bodies;
c) To treat policyholders fairly and meet the reasonable expectations of with-profits policyholders;
d) Subject to (a), (b) and (c), to maximise the financial returns to with-profits policyholders and the shareholder.

2.2 LICI is wholly owned by the Government of India, and currently distributes a dividend of 5% of the distributed surplus to the shareholder. The distribution is governed by the Life Insurance Corporation Act 1956 as amended from time to time. This states that where a surplus emerges "ninety percent or more such surplus, as the Central Government may approve, shall be allocated to or reserved for the life insurance policyholders of the Corporation."

2.3 The Branch has a single long-term business fund in which all insurance business is transacted. A separate Shareholder Fund also exists within the Branch and is the vehicle via which the Branch distributes surplus to the shareholder. All income and expenses of the long term business are allocated to the long-term business fund, other than any expenses assumed to be paid by the shareholder, including any mis-selling costs and any subsidies provided by the shareholder. In particular, where deemed appropriate, the expenses charged to the long-term business fund may be limited to amounts that are consistent with any illustrations given to policyholders.

3 The amount payable under a with-profits policy

Principles

3.1 In assessing the amounts payable under a with-profits policy, the aim of the methods used is to meet the objectives as set out in 2.1. Importantly, they aim to provide policyholders with a fair return on their policy that reasonably reflects the experience of the fund whilst the policy has been in-force but is subject to any smoothing, as discussed in section 5.

3.2 Bonus is generally distributed by means of annual (also known as reversionary) bonus and final (also known as terminal) bonus. The amount payable under a with-profits policy is generally determined by reference to a guaranteed basic benefit, the attaching annual bonuses and the final bonus applicable at the date of claim. The exception to this is the with-profits ISA where the amount of the basic benefit is not guaranteed.

3.3 Where practical, the Branch calculates asset shares to assist in determining the pay-out due on maturing policies.

3.4 The Branch will also conduct investigations and projections to establish the appropriate proportion of bonus and pay-out to be paid in final (non-guaranteed) form. The proportion is assessed having regard to the targeted free asset position, investment mix and the desired level of equity required between generations and classes of policyholders.

3.5 In applying the methods to determine the amounts payable under with-profits policies, there is a need to consider historical experience and, where appropriate, make assumptions about the past. In the light of new information, different methods or new techniques, the Branch may change any assumptions used regarding the historical experience. In making any changes the Branch will have due regard to the fair treatment of with-profits policyholders and the materiality of any change.

Practices

Asset Share Calculation for policies other than ISAs

3.6 Asset shares are currently calculated for all non-ISA with-profits policies except whole of life policies. This section therefore does not apply to those whole of life policies.

3.7 Bonus rates are set after consideration of the asset shares of individual premium-paying policies. Accurate data relating to investment returns and expenses from the point of sale onwards is not always available and, where necessary, approximations have been used. The asset shares are used as a guide to determine how much, if any, final bonus should be paid.

3.8 The asset share for an individual policy is calculated by taking into account the premiums paid, deducting the expenses incurred under the policy and the cost of mortality (see 3.11below), surrenders and miscellaneous surplus and rolling this amount up at the rate of investment return earned on the assets. The calculation of expenses is based on the premium paid, the asset share and a fixed cost per policy, although the expenses applied to each asset share may be limited to ensure they are reasonable. Any expenses in excess of any limits would normally be charged to the Shareholder Fund.

3.9 Allowance is made for the expenses incurred over the period, by expressing the new expenses in the year the policy was taken out as a percentage of annualised new business premiums and the renewal expenses for all subsequent years as a percentage of revenue premiums excluding new premiums. Smoothing may be applied to the expense percentages from year to year.

3.10 The asset share calculations for the period up to and including March 1996 assume an investment return based on index returns and in later periods assume an investment return based on the investment income and changes in capital values of the whole fund expressed as a percentage of the liabilities. It also allows for a different assumed investment mix for the ISA policies. Allowance is made in the calculations for the tax paid on investment return and tax relief received on expenses.

3.11 Credit is given for mortality over the period, with the mortality assumed to be equal to the current best estimate assumption, which is set after considering experience. The cost of the actual mortality experience is charged to the asset share, so the asset share is increased where actual mortality experience is better than that assumed in the premium basis. Credit is given for profits arising from surrenders and other miscellaneous sources, allocated in proportion to asset share.

The investment return used to calculate the asset share is reduced by 0.25% pa to fund the cost of guarantees and the cost of capital.

3.12 Surplus arising from non-profit business is included in the miscellaneous surplus that is allocated to the asset share. Therefore surplus arising from non-profit business is allocated between the policyholders and shareholders in the same way as any other surplus, as set out in section 2.2

Shadow Portfolio Calculation for ISAs

3.13 The amounts payable under an ISA are set with respect to a shadow portfolio calculation rather than an asset share. The calculation is a roll-up of premiums with investment return, reduced to allow for any charges applied to the ISAs.

3.14 When considering the investment return, the ISA business is assumed to be invested 50% in equities and 50% in fixed interest securities. The percentage returns for each of equities and fixed interest securities are those calculated for the assets of that type held by the fund as a whole.

Pay-outs on maturity

3.15 On maturity, the Branch aims to pay an amount which is between 80% and 120% of asset share.

3.16 If policies have sum assured and bonus in excess of this amount, they will receive a percentage of asset share in excess of 120% but bonuses would be kept at low levels until most pay-outs fall within the target range.

Pay-outs on surrender

3.17 On surrender, the Branch aims to pay an amount which is between 75% and 115% of asset share.

3.18 The surrender value for some policies may be in excess of this amount and so they may receive a percentage of asset share in excess of 115% if they surrender, but it is intended that bonuses would be kept at low levels until most pay-outs fall within the target range.

3.19 The Branch will not pay a surrender value if the policy surrenders within two years of inception. In certain cases, a paid-up policy may be granted.

3.20 If an ISA policy is surrendered or transferred to another provider at other than a date where a guarantee applies, a Market Value Reduction may be applied. This will happen if the market value of the assets in which the ISA is notionally invested has fallen below the face value of the units allocated to the ISA. A surrender penalty may also be applied to a surrender in the early years to enable the Branch to recoup some or all of its initial costs.

Other matters

3.21 The Branch has issued some unit-linked policies that are wholly reinsured to a life insurer within the Aviva Group, which may give rise to an additional tax charge for the Branch. This would not be specifically charged to the existing with-profits policyholders, although it would affect the amount of surplus emerging for distribution. Reinsurance commission received in respect of this business goes into the surplus.

3.22 Where additional capital has been provided by the shareholder to the Branch, such as to meet the one-off costs of a change in administration arrangements, this capital and any associated investment return is deemed to belong to the shareholder and no charge is made for the use of that capital.

3.23 The Actuary documents the methods, parameters and assumptions used to determine the amount payable to policyholders and any transfers to be made to the Shareholder Fund, and key aspects are contained in reports presented to the Board.

4 Annual and Final Bonuses

Principles – annual bonuses

4.1 The general aim in declaring annual bonuses is to provide with-profits policyholders with additional guarantees above the guaranteed basic benefits that increase over time. These guarantees apply to the policy at death or maturity but are not guaranteed in nominal terms on earlier termination, except where specific guarantees are given, such as for market value reduction-free dates for ISAs.

4.2 The Branch may declare separate annual bonus series for different classes and generations of contract.

4.3 The starting point for the approach used is to consider the sustainability of bonus rates that do not depart significantly from those declared in recent years, having particular regard to the financial impact on the Branch in terms of its projected free asset position.

4.4 The Board aims to set annual bonus rates that do not fluctuate widely from declaration to declaration on a year to year basis, and to give policyholders a reasonable expectation that similar bonuses can be declared in future years. However, the bonus rates will change, if our view of the future long term experience changes, with due regard to policyholder reasonable expectations and recent bonus levels. Bonuses will only be declared if there is a surplus in the fund.

Practices – annual bonuses for policies other than ISAs

4.5 Annual bonus rates are declared at the discretion of the Board. Current practice is to set rates for conventional contracts annually in arrears. In the normal course of events, the Board would not expect to re-set annual bonus between declarations. However, in the event of a significant change in economic circumstances that could adversely affect the surplus expected to be available for distribution, the Board can use its discretion to alter annual bonus rates at any time

4.6 The Branch currently has two annual 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. Within each series, the bonus declared for a particular policy may vary according to the exact type and term of that policy.

4.7

4.8 As described above, the Board's aim is to set annual bonus rates that will change relatively infrequently and avoiding wide fluctuations. Nevertheless, the Board does not have any maximum amount by which annual bonus rates would alter. In a situation where solvency was under threat, or there is not expected to be sufficient surplus in the fund, the Board may act to reduce annual bonus rates significantly. Indeed, in extremis, it may decide not to declare a bonus.

4.9 For the First Series, historic bonus rates were set based on the investment income earned in the fund. During the 1990s, bonus rates were reduced more slowly than the fall in interest rates warranted. Current bonus rates for this series reflect the move to a lower interest rate environment and the substantial guarantees given in the premium rates. This means that they are currently at low levels and are likely to remain so.

4.10 For the Second Series, which has a lower guaranteed sum assured than the First Series, the intention is that annual bonus rates should be no higher than the rate earned on the fixed interest investments of the fund, after allowing for guarantees implied in the premium rates and taking expenses into account. The declaration will also take account of current and expected future economic and demographic experience over the lifetime of the policy, and the investment policy. It will be set to include an appropriate margin for final bonus. The latter is important to permit greater investment freedom and establish equity between generations and classes of policyholders.

4.11 Annual bonuses for both First and Second Series policies are expressed as a percentage of the sum assured. This is usually referred to as a simple bonus system.

4.12 If a with-profits policy is made paid up before the end of its contractual term the annual bonus added to date is credited to the policy, but the policy then becomes non-profit and receives no further bonus additions.

4.13 Where circumstances change to such an extent that it would be unfair to existing or new business policyholders to share the same rates of bonus, the Board may, on the advice of the Actuary, decide to declare an alternative bonus series, amend the basis of the contract or withdraw the type of policy altogether. Such a scenario could arise if using the same bonus series would lead to subsidy of new policies by existing policies.

4.14 The Branch has on its books a very small number of policies that were acquired from other companies when the Indian Government nationalised the industry in 1956. Such policies receive a bonus that is a pre-defined percentage of the main declaration. The percentage is shown in the following table.

4.15

Issuer	Percentage of Standard Rate
All India and Burma Provident Fund	140%
Gresham Life Assurance Society	130%

Issuer	Percentage of Standard Rate
Norwich Union Life Insurance Society	
Aryan Champion Insurance Company	120%
Indian Mercantile Insurance Company	
Oriental Government Security Life Assurance Company	
Prudential Assurance Company	
Asian Assurance Company	110%
Bombay Life Assurance Company	
Bombay Mutual Life Assurance Society	
Industrial & Prudential Assurance Company	
New Asiatic Insurance Company	
New Great Insurance Company of India	
New India Assurance Company	
Universal Fire & General Insurance Company	
Jupiter General Insurance Company (all policies)	
General Assurance Society	100%
Hindustan Co-operative Insurance Society	
Lakshmi Insurance Company	
Life Insurance Corporation of India (Including policies issued after 19.01.1956 by Insurers other than Jupiter General Insurance Company, Mysore Government Insurance Department and Patiala Insurance Corporation)	
National Insurance Company	
Asiatic Government Security Life & General	
Assurance Company	
Prithvi Insurance Company	
Indian Life Assurance Company	

4.16 Bonuses are allotted to all conventional participating policies in force for the full Sum Assured on 31st March in each year. For those policies issued by the insurers whose business has vested in the Corporation (see table above), the entitlement to annual bonus includes policies which have been made paid-up for a reduced Sum Assured.

4.17 With-profits policies which become claims by death or maturity or which are surrendered prior to the bonus declaration for the year are entitled to an interim annual bonus, normally at the same rates as applied at the previous declaration date. In the case of surrenders, only a proportionate bonus will be allowed in respect of the policy year current on such date unless all instalments of premiums for the policy year have been paid before the date of surrender.

Practices – annual bonuses for ISAs

4.18 The ISA bonus rate is normally reviewed every six months at the discretion of the Board and the rate is applied on a daily basis for the following six months. So a policy that has been in force for six months will have accrued half a year's bonus. In the normal course of events, the Board would not expect to re-set annual bonus between declarations. However, in the event of a significant change in economic circumstances that could adversely affect the surplus expected to be available for distribution, the Board can use its discretion to alter annual bonus rates at any time.

4.19 The with-profits ISA operates on a compound bonus system. In this case, the bonus is declared as a percentage of the accumulated fund. This bonus rate is also set in a different manner. The ISA has no "sum assured" and the fund is the accumulation of premiums to date plus the bonus rate net of the fund management charge.

4.20 The ISA is deemed to be invested 50% in fixed interest securities and 50% in equities, as discussed in section 3.14. The bonus rate is set by considering the yield available on fixed interest securities and reducing this by the management charge and a prudent margin. The fund's performance is measured using a shadow portfolio and to the extent that the performance of the shadow portfolio exceeds the annual bonus granted and any surrender penalty, a final bonus will normally be payable. However if the policy is surrendered at a time when the value of the shadow portfolio is less than the face value of the units allocated (including vested annual bonus) then a Market Value Reduction may be applied.

Principles – final bonus

4.21 In determining the total pay-out on a policy becoming a claim, the Branch may add a final bonus aimed at increasing the benefits guaranteed under a policy to the underlying value of that policy as assessed by the experience throughout its lifetime within the fund.

4.22 The Branch may declare separate final bonus series for different classes and generations of contract.

Practices – final bonus for policies other than ISAs

4.23 Final bonus for both First and Second Series policies are expressed as a percentage of the sum assured. This is usually referred to as a simple bonus system.

4.24 Final bonus rates are declared at the discretion of the Board on the advice of the Actuary. The levels of final bonus rates are reviewed at regular intervals, not less frequently than annually, but more frequently when significant changes in investment market dictate.

4.25 Any final bonus is generally only paid on claims where the policy has been in force for a minimum number of years varying by type.

4.26 Separate scales of final bonus may apply to First Series policies expressed in sterling and rupees.

4.27 One or more separate scales will be determined for Second Series policies.

4.28 With-profits policies that become claims prior to the bonus declaration for the year are entitled to an interim final bonus at the same rates as applied at the previous declaration date.

4.29 Where a convertible Whole Life policy or a without profit policy is converted to a with profit policy, the qualifying period for final bonus will be reckoned from the date of policy anniversary from which it is entitled to participate in profits.

4.30 Under Children's Deferred Assurance Policies, duration at claim will be reckoned only from the deferred date (vesting date).

Practices – final bonus for ISAs

4.31 Final bonus for ISA policies will be expressed as a percentage of the accumulated fund.

4.32 Final bonus rates are declared at the discretion of the Board on the advice of the Actuary. The levels of final bonus rates for ISAs are reviewed at least monthly and more frequently when significant changes in investment market dictate.

5 Smoothing

Principles – smoothing

5.1 In framing a bonus declaration, the Actuary compares the pay-out on a maturity claim with that for a similar policy maturing in the previous year to ensure it is not inconsistent.

5.2 The smoothing policy of the Branch has regard to factors such as the bonus policy, level of free assets, the investment mix and the policyholders' reasonable expectation. The General Principles 2.1(b) and (c) are of vital importance in this regard.

5.3 The cost of smoothing will be monitored at least annually.

5.4 The total cost (and hence scale) of smoothing must inevitably be subject to the availability of adequate resources and cannot be allowed to grow too large in relation to the size of the long term business fund. The aim would however be to target a zero cost of smoothing over a reasonable period of time.

Practices – smoothing

5.5 The current smoothing methodology does not differentiate between generations and types of with-profits policies, but this may change in future.

5.6 The current approach to smoothing is to limit the change in amounts payable under a with-profits policy to 10% from one declaration to the next in normal circumstances. However, as described in the practices governing annual and final bonus rates setting, the Board can, on the advice of the Actuary, depart from this 10% limit (or make declarations more frequent than annually) should the financial condition of the fund so dictate. The cost of smoothing would be a constraint on the smoothing policy; such cost should be reasonable in relation to the Branch's solvency position.

5.7 Claim pay-outs on surrender will receive any entitlement they may have to final bonus depending on duration in force. The formula applied to surrender values and paid up values reflects economic conditions and can be changed by the Board on actuarial advice. However, any such change will be constrained by the need for surrender pay-outs to fall within the target ranges given above.

5.8 For the ISA contract, the annual bonus rate is set on a smoothed basis and final bonuses will apply according to the dates on which premiums have been paid and any partial withdrawals have been taken.

6 Investment Strategy

Principles

6.1 The Branch's investment strategy supports the key financial objectives set out in Section 2. It is currently based on the view that while the security of the investment is paramount, there are advantages in investing a proportion of the portfolio in equities and property as these can be expected over the longer term to produce a better investment return than can be achieved by investing solely in cash and bonds.

6.2 The strategy, therefore, is to invest a high proportion of the funds in fixed interest investments but to invest the balance in equities and property with the aim of improving the investment return available to with-profits policyholders subject to an acceptable degree of risk. The strategy takes into account any limits set by regulators and the risks of each asset type, and the potential effects on the Branch's capital requirements.

6.3 The asset classes that the Branch will consider are UK and overseas equities, fixed interest investments (such as gilts and other bonds), cash and property.

6.4 In setting investment strategy, the Branch has regard to the nature and term of its long-term business liabilities, the extent of any guarantees applying and the need to demonstrate solvency. In theory, guaranteed benefits should be backed by fixed interest assets of the appropriate term and security but investment strategy can vary from this to the extent that free assets allow the Branch to support the resulting capital requirements. Regard is also paid to the expectations of policyholders in relation to the nature of the assets backing their policies.

6.5 In determining the investment strategy and extent of deviation away from the theoretical matched position, the Branch can rely upon any long-term business assets, including those held outside the long-term fund and no distinction is drawn between with-profits and non-profit liabilities.

6.6 There are no constraints that apply with respect to parts of the fund either on account of separate policy classes or generations of business.

Practices

6.7 The Branch outsources its investment management. The Branch Management Committee is responsible for maintaining a sound system of control over the investment risk in all its forms. The Branch Management Committee meets quarterly.

6.8 The investment management agreement includes objectives, guidelines and constraints. Monthly and Quarterly reports are provided for review purposes. A formal investment review is currently carried out at least annually. The Branch has a relatively conservative investment policy with the emphasis on maintaining the security of the funds through investment in fixed interest securities.

6.9 For the purposes of the approach to investment, the long-term business fund can currently be considered as a single entity incorporating all the assets and liabilities of the Branch other than the assets in the Shareholder Fund. The Shareholder Fund may use a different investment approach to the long-term business fund.

6.10 The fund will invest in derivatives only for the purpose of reducing risk.

6.11 Any proposal to invest in a new or novel investment instrument would require approval by the Board based on a recommendation from the Investment Management Committee who in turn would seek advice from the Actuary.

6.12 The Branch’s only holding of an asset that would not normally be traded is limited to a small (less than 5% of funds) property portfolio, which are either used to accommodate senior staff while on secondment to the UK branch or rented out. The scale of this investment is not material in determining claim values and imposes no practical constraint on investment freedom.

7 Business Risk

Principles

7.1 Business risks for the long-term business fund will include the acquisition and maintenance of with-profits and non-profit business. New business arrangements are specifically covered in Section 10.

7.2 Any new venture involving significant resource or risk will be subject to a full cost benefit justification and risk assessment. It will require approval from the Board in India.

7.3 In general, any business risks outside the routine risks of effecting and carrying out insurance contracts would be supported by shareholder capital, and profits or losses arising would be borne by the shareholder and not attributed to with profits policyholders.

7.4 The assets attributable to the UK long-term business are maintained and managed in the UK.

Practices

7.5 There is a risk that future expenses under the third party management arrangement will be higher than at present resulting in less surplus available for distribution. This could happen, for example, if the business volume stays lower than projected and as a result the per policy costs are higher than expected. The LICI Board has undertaken that excess costs of this nature will be borne by the estate rather than by the individual policyholder.

7.6 The Branch does not operate formal limits on the taking on of business risk.

7.7 The profits from the non-profit business accrue to the policyholders and shareholder in the same proportion as other surplus.

7.8 Any new venture involving significant resource or risk which had an impact on the relationship with the third party administrator would need to be agreed by the Branch Management Committee and a representative of the third party administrator.

7.9 There is currently no exposure to risks from other investments in subsidiary or associated operations.

7.10 The successful continuation of the outsourcing arrangement is a significant source of risk for the With Profit policyholders. The Branch has the right to inspect the provision of services under the agreement to ensure that such services are being provided in a satisfactory manner. In the event of its termination, the responsibility of each party to the arrangement is laid down in the agreement.

8 Charges and Expenses

Principles

8.1 The aim of the Branch’s approach to apportioning expenses to with-profits policies is that it should be fair and appropriate.

8.2 The basis upon which expenses are apportioned seeks to reflect the drivers and the activities that give rise to such expenses.

Practices

8.3 The Branch’s expenses are wholly attributable to the management of the long-term business operations. Expenses cover the acquisition of business (including commission) and the maintenance of business that includes administration and investment management as well as other costs. Costs are split between acquisition and maintenance. The basis on which expenses are apportioned reflects the drivers and the activities that give rise to such expenses. Bases used include those based on time analysis, numbers of policies, percentage of premium, mean fund size or, indeed, a factoring up of direct costs. The apportionment bases used from time to time have regard to ease of application and consistency as well as fairness.

8.4 The acquisition and renewal expense ratios which are derived are applied to both non-profit and with-profits business.

8.5 Any expenses included and apportionment basis adopted must be appropriate for the purpose and compliant with any relevant rules and guidance. In general, all costs will be included and apportioned but circumstances can arise where adjustments may be appropriate, for example, in determining the amounts payable under with-profits policies. By way of example, adjustments may be made to allow for the amortisation of significant development costs, non-recurrent expenditure and (providing it is of sufficient size) subsidy by the estate.

8.6 A basis change might be introduced to reflect changes to these drivers or activities (e.g. new outsourcing arrangements). It might also be introduced to accommodate new business methods and practices (e.g. new distribution). It may simply be introduced to improve the current apportionment basis in the light of new information.

8.7 An expense analysis is performed at regular intervals (at least annually) and this will include a review of any apportionment methods and bases adopted to ensure they remain appropriate over time.

8.8 There are no current circumstances under which the Branch will charge expenses at an amount higher than cost. However, the expenses charged to policyholders are sometimes limited as set out in section 2.3.

8.9 The third party management company that carries out administration for the Branch makes specific charges for the setting up of new business and the administration of existing business, and these charges are allocated to new and renewing policies accordingly.

8.10 The charges for fund management made for investment management are deducted from the investment income before it is allocated.

8.11 The costs of other external services will be allocated based on an assessment of relative amounts of time spent.

8.12 Changes to the charges made as a result of the third party administration agreement will be approved by the Branch Management Committee.

9 Management of the Inherited Estate

Principles

9.1 The term "inherited estate" is normally used to refer to surplus which has accumulated over the years and is not attributable to the current generation of policyholders.

9.2 The term "free assets" includes the inherited estate, if any, plus shareholders' capital and any surplus attributable to the current generation of policyholders which will be distributed in the form of a final bonus on exit. It is generally defined as the excess of the total assets over the statutory liabilities and capital requirements.

9.3 The free asset ratio is determined by expressing the free assets as a percentage of total assets. The Branch does not have an explicit target in terms of the size of its free assets.

9.4 There are no constraints on the Branch's freedom to manage the inherited estate as a result of previous dealings.

Practices

9.5 The Branch has no "inherited estate" as defined in 9.1, as over time all available surplus has been distributed to policyholders. The current free assets arise as a result of transfers of capital from the Head Office in India, investment return on that capital, surplus attributable to existing policyholders which has not yet been distributed and miscellaneous profits.

9.6 The Branch intends to keep its capital intact and to build up the estate by virtue of interest earned on the free assets and by making a charge to asset share for the capital support that policyholders have enjoyed during their membership of the fund. Miscellaneous profits arising on non-contractual exits, which have not been distributed to policyholders, will also continue to build up the free assets.

9.7 In addition, by holding back some of the emerging surplus to be paid as final bonus when a policy becomes a claim, the Branch is building up some free policyholder reserves as part of the free assets, on top of the existing shareholder capital.

9.8 The Branch aims to have a free asset ratio sufficient to give the Branch freedom to manage its business in the best interests of policyholders and other stakeholders. For example, it should enable the investment strategy as set out in Section 6 to be pursued with the prospect of higher investment returns. It can enable higher levels of new business to be written which can help contain or reduce unit costs. It can enable greater smoothing in terms of pay-outs and reduce the immediate impact of financial shocks due to economic change or business risk.

9.9 The free assets are available to meet all costs associated with the long-term business operations. No explicit allowance is made for the free assets in determining the amounts payable under with-profits policies.

9.10 The investment strategy for the free assets is the same as the strategy for the rest of the long-term business fund.

9.11 In general, the assets backing with-profits policies would not be expected to be applied to fund major business risks. Such risks would normally be funded by the free assets or by a further injection of capital from the shareholder and would be subject to robust risk analysis before implementation.

9.12 Where the free asset ratio falls to a level that does not give sufficient freedom as described in 9.8, the aim would be to restore the position to within this range over a maximum five year timeframe, provided this did not lead to the material unfair treatment of policyholders. The Branch undertakes regular investigations into the projected statutory solvency position under a range of scenarios. The results and conclusions from these investigations are used to decide upon appropriate actions to manage the scale of the free asset ratio over time.

10 Management of new business

Principles

10.1 The primary consideration in the setting of new business volumes is the level of resource (both in terms of capital and processing capacity) required. Projections of the Branch under different scenarios are used to establish any maxima in terms of limitations of the Branch's financial capacity to take-on new business where this becomes an issue. This would have regard to business mix if appropriate.

10.2 Consideration would also be given to the nature of the products being sold, their potential suitability for customers, the financial and business risks associated with the products and the methods and terms upon which they are sold as compared with the market. New business should only be sold if it is in the interests of the existing with-profits policyholders.

10.3 Should the Branch determine that it is not in the interests of with-profits policyholders to remain open to new business, it will develop a closure plan. This will include a strategy for managing the closed book of business and how any inherited estate will be distributed over the expected lifetime of the with-profits policies.

Practices

10.4 There are no specific practices regarding the setting of new business volume limits beyond those implied by the principles set out previously. Currently maximum volumes and business mix are not an issue.

10.5 The Branch has set no minimum scale in terms of new business volumes to justify staying open to new business. However, the position is subject to review from time to time according to the principles set out previously. The likely progression of unit costs and investment freedom under alternative scenarios would be key factors in any decision taken.

11 Allocation of profits

Principles

11.1 The Life Insurance Corporation of India is 100% owned by the Government of India (the shareholder).

11.2 The distribution of surplus between the policyholders and the shareholder is governed by the provisions of the Life Insurance Corporation Act as amended from time to time.

11.3 The current provisions of the Act allow 5% of the distributable surplus to be paid to the shareholder.

11.4 As per the provisions of the Act, the Shareholder can approve varying the surplus to be allocated to policyholders.

Practices

11.5 The current practice is that 5% of the surplus emerging from the valuation of the conventional business is remitted to India for the benefit of the shareholder. Following long-established practice the share of surplus is calculated on the assumptions used for the valuation of the with-profits liabilities.

11.6 Policyholders have no specific rights to surplus emerging from sources other than with profits business.

11.7 The Branch operates a single long term business fund and the surplus emerging from non-profit business will be determined as the cash flows attributable to that business including an appropriate allocation of expenses and investment income.

12 Glossary

the Actuary	the With-Profits Actuary of the Branch, who has the responsibility under Financial Conduct Authority rules for advising the Board on its application of discretion in relation to with-profits policies
asset share	a measure of the share of assets attributable to a with-profits policy, calculated by accumulating, at the rates of return earned on the assets assumed to be backing the policy, the premiums paid less expenses, tax and risk benefits, in accordance with the actual experience of the Branch
the Board	the Board of the Life Insurance Corporation of India
the Branch	the UK Branch of the Life Insurance Corporation of India
final bonus	a method of distributing surplus, whereby the bonus is not guaranteed and is only declared when a policy becomes a claim
First Series policy	a single premium policy issued before April 2002 or a regular premium policy issued before February 2004
free assets	the excess of the total assets over the statutory liabilities and capital requirements
inherited estate	any part of the free assets which is not attributable to the shareholder or the current generation of policyholders
ISA	an Individual Savings Account policy
LICI	The Life Insurance Corporation of India
paid-up policy	a policy initially issued as a regular premium policy where the policyholder has chosen to stop paying premiums but retain the policy
Second Series policy	a single premium policy issued after March 2002 or a regular premium policy issued after January 2004
with-profits	a policy or group of policies which can share in the profits and losses of the Branch, as they are eligible to participate in any established surplus through the addition of policy bonuses