

2009 Annual Report to With Profits Policyholders

Introduction

The way in which MGM Advantage manages its With Profits business is set out in the Principles and Practices of Financial Management (PPFM). A customer friendly version called "MGM Membership - Your Guide" has been prepared and you can find the document and the full PPFM on our website, www.mgmadvantage.com, or by calling our Customer Centre on 01903 836067.

The Society is required to report each year on compliance with the obligations documented in the PPFM, together with appropriate justification. This report covers compliance during 2009.

The Society's With Profits Actuary is also required to report to With Profits policyholders and a copy of his most recent report is also available on our website.

Independent oversight of the treatment of With Profits business is provided by the Society's With Profits Committee. This committee has the right to report to policyholders and, in particular, would do so if it considered that this report did not provide a full and fair view. The committee has chosen not to provide any additional report this year.

Statement on Compliance

It is the Board's opinion that the management of the Society's With Profits business during 2009 has been in accordance with the PPFM. In particular, discretion available to management in the conduct of the business has been exercised in an appropriate way and the competing rights of different policyholders have been taken fully into account.

Commentary

2009 has been another difficult year for investment management. We have seen significant falls in virtually all investment classes early in the year followed by a variable recovery.

The setting of the various bonus scales that are used to calculate payouts on With Profits policies requires considerable discretion to be exercised. The economic turmoil has emphasised this requirement.

Scales for Conventional With Profits business were reviewed from 1st April as planned, and scales for Unitised With Profits business were reviewed each quarter.

In addition, the deterioration in markets during the first quarter of the year meant that an additional review of Unitised With Profits bonus scales was required in March 2009. Finally the recovery in markets over the year led to an additional review of Conventional With Profits bonus scales in December 2009.

In deciding bonus rates, we take account of the following factors;

- I. the underlying fair share for each group of policyholders, based on the Society's performance, how much is invested and any charges we make
- II. our stated smoothing policy
- III. the extent to which we need to maintain a cushion to adequately reflect the solvency of the fund.

During the year we largely reverted to our normal practices following the exceptional changes made towards the end of 2008. In particular;

- Tax adjustments made during 2008 were not repeated however Life business policies continue to be credited with capital gains without any tax deduction and this will continue until markets recover sufficiently.

- We reverted to charging losses in respect of expense overruns during the year to the estate rather than to policy asset shares. Following the successful development of our enhanced annuity business during 2009 and the prospect of further progress with the launch of FIA (see more below) early in 2010 we are anticipating real progress in addressing these losses in the near future.

A full explanation of how we decide bonuses can be found in "MGM Membership - Your Guide".

At each review, the With Profits Actuary advises the Board separately on whether the proposals developed by the Society represent reasonable exercise of discretion, taking account of the PPFM. For each bonus declaration covering 2009, the With Profits Actuary advised that discretion had been reasonably exercised.

Another key area of discretion relates to the investment of the funds supporting the With Profits business. Investment mix is monitored regularly by the Society's Investment Committee. At the end of the first quarter the Committee decided to make a major strategic switch out of equities and into corporate bonds to benefit from what were perceived as attractive corporate bond valuations. The new mix of investments stayed within the wider investment ranges specified in the PPFM principles but moved outside the narrower monitoring ranges specified in the PPFM practices. The PPFM practices have now been updated to reflect new operating ranges taking this into account.

A significant proportion of the Conventional With Profits business is maturing over the next few years and it is likely that the high proportion of fixed interest investment will be maintained over this period to protect against any further market set backs that may occur and to facilitate the management of this business. This position will remain under review.

The PPFM has target ranges for payouts. Payouts are monitored against these targets, and we can report that during 2009 over 90% of payments on Unitised With Profits policies were within these ranges. For Conventional With Profits payments close to 100% of payouts on maturity were in the specified ranges but the number of payouts on surrender inside the specified ranges fell short of the 90% target. The majority of surrender payouts outside the specified ranges were in excess of the target amounts as the surrender payments made recognise guarantees due to be paid and give some credit for this.

MGM Advantage consulted on changes to the principles and practices in the PPFM during 2009. This process was to allow for the introduction of the new Flexible Income Annuity ("FIA") product which was originally anticipated in the second half of 2009. This is a With Profits contract but shares in profits in ways that differ from existing contracts in some respects and hence the need for change. The consultation exercise was successful and no policyholders raised concerns with the changes.

In practice the FIA launch was affected by a wide ranging review of With Profits business and mutual insurers by the Financial Services Authority which resulted in a delay until early 2010. The PPFM was then updated at the time of launch.

Finally the PPFM has guidelines on the Society's estate and the level of business risk to be taken by the With Profits funds. The financial position has improved over the year and the launch of FIA and other new business developments are aimed at supporting further improvements over the medium term. However the estate remains below the level that our risk appetite as stated in the PPFM would suggest and hence the Board is looking at further actions to rectify this situation.

Looking Ahead

The Directors expect that the continuing restructuring of our new business operations, including the launch of FIA, will contribute to a build up of surplus over the next few years and we look forward to sharing this benefit with With Profits policyholders in due course.

The Board of Directors
24 March 2010



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